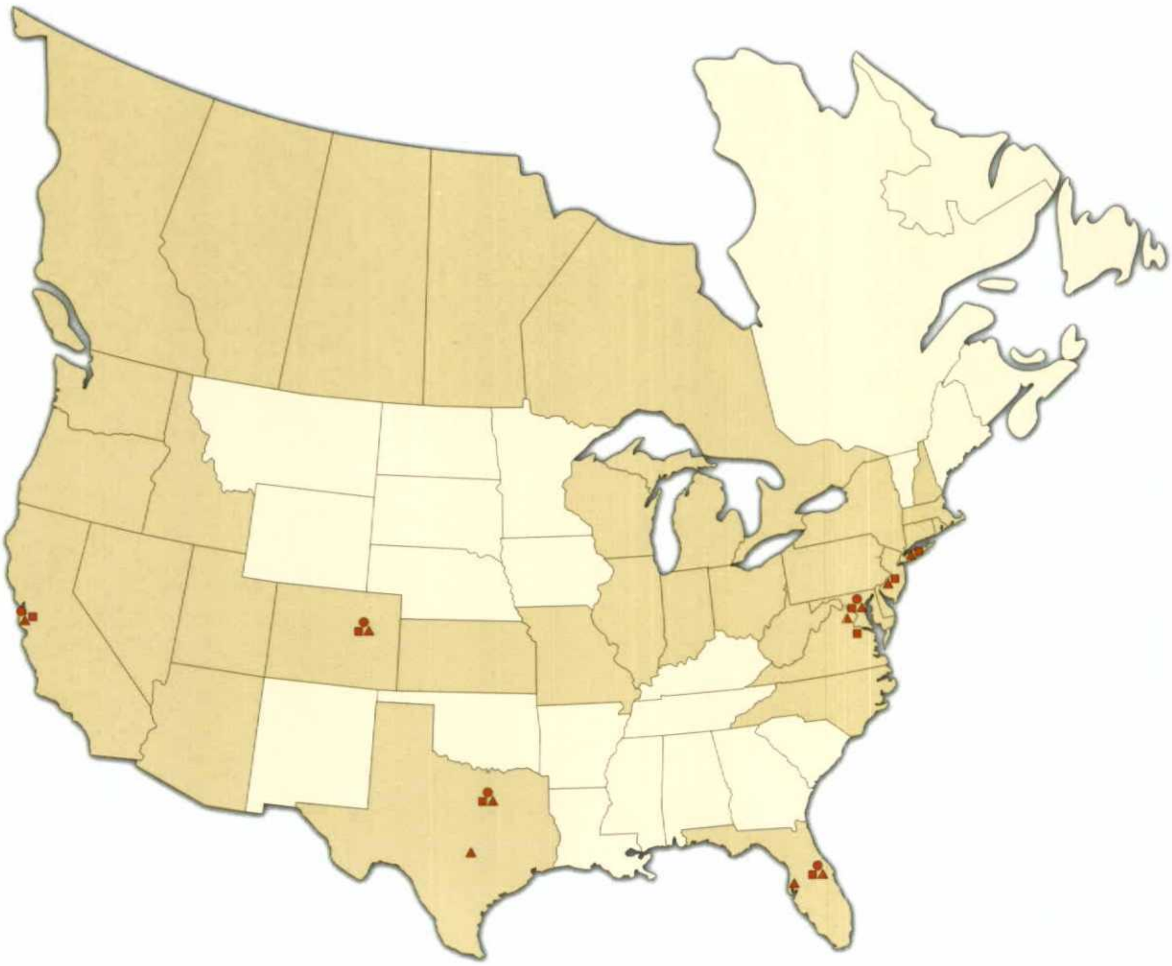
The Southland Corporation

1996 ANNUAL REPORT

The Southland Corporation
United States and Canada System



Stores Network	Total
☐ 7-Eleven and other retail locations	5,422

Fresh Products Distribution Network*	Total
■ "Deli Central" Commissaries	7
● "World Ovens" Bakeries	5
▲ Combined Distribution Centers	11

**Owned and operated by third parties.*

7-Eleven Around the World

United States:	
Franchised	2,927
Company-operated	2,040
Canada:	
Company-operated	455
	5,422
Licensed or Operated by Affiliates (1)	
Japan (2)	6,765
Taiwan	1,346
Thailand	714
United States	620
Hong Kong	331
Mexico	220
Australia	162
South Korea	125
Philippines	105
Malaysia	101
Spain	92
Singapore	81
United Kingdom	55
Norway	41
Sweden	37
China	30
Denmark	22
Brazil	14
Puerto Rico	12
Guam	10
Turkey	9
	10,892
	16,314

(1) Sales from stores operated by licensees or affiliates are not included in Southland's "Net Sales." Royalties from licensees are included in "Other Income."

(2) The 7-Eleven licensee in Japan, Seven-Eleven Japan Co., Ltd., and its parent company, Ito-Yokado Co., Ltd., jointly own IYG Holding Company, which owns approximately 65% of Southland's common stock.

State/ Province	7-Eleven Stores	Other Retail	Total
United States:			
Arizona	96	0	96
California	1,168	3	1,171
Colorado	240	0	240
Connecticut	38	0	38
Delaware	27	0	27
District of Columbia	18	0	18
Florida	417	0	417
Idaho	14	0	14
Illinois	138	6	144
Indiana	16	4	20
Kansas	17	0	17
Maryland	315	2	317
Massachusetts	35	1	36
Michigan	99	0	99
Missouri	81	2	83
Nevada	188	0	188
New Hampshire	9	2	11
New Jersey	203	0	203
New York	229	0	229
North Carolina	7	0	7
Ohio	15	0	15
Oregon	133	0	133
Pennsylvania	166	0	166
Rhode Island	8	0	8
Texas	286	2	288
Utah	112	0	112
Virginia	598	6	604
Washington	228	0	228
West Virginia	23	0	23
Wisconsin	15	0	15
Canada:			
Alberta	116	0	116
British Columbia	141	0	141
Manitoba	50	0	50
Ontario	110	0	110
Saskatchewan	38	0	38
Total	5,394	28	5,422

All numbers as of December 31, 1996

▲ 1927
The Southland Ice Company is founded in Oak Cliff, a suburb of Dallas, Texas. An ice dock employee, Uncle Johnny Green, stocks milk, eggs and bread to better serve his customers' needs. Convenience retailing is born.

▼ 1928
The Model T is 20 years old, and 10 Southland stores, now known as Tote'm stores, become the first to sell gasoline. Genuine Alaskan totem poles decorate several store locations.

▲ 1946
The name "7-Eleven" is created for the growing chain of neighborhood stores that are open from 7 a.m. until 11 p.m. The first store logo combines a four-leaf clover, the numeral 7 and the word "Eleven."

▼ 1949
7-Eleven's animated "Owl and Rooster" commercial is the first television advertising by any convenience store. Decades later, mature Dallasites will still remember the catchy jingle.

▲ 1954
The first 7-Eleven stores open outside of Texas. The warm weather and leisurely lifestyle of Miami and Jacksonville, Florida, make them perfect markets for 7-Eleven's brand of convenience.

Proudly celebrating 70 years of fulfilling

▲ 1958
Southland expands to the East Coast by opening stores in Virginia, Maryland and Pennsylvania, proving that the 7-Eleven concept works in all climates.

▼ 1963
In tune with customers' changing lifestyles, 7-Eleven begins operating stores "around the clock." That same year, the company purchases 100 Speedee Marts in California and enters the world of franchising.

▲ 1966
Slurpee, a new frozen carbonated beverage, is introduced and immediately enhances the attractiveness and profitability of 7-Eleven. By the end of the following year, Slurpee® sales total 150 million cups.

▼ 1969
Echoing the sentiments of its customers, the "Oh Thank Heaven" slogan is introduced. It becomes one of the longest-lasting and most popular themes in retail history. That same year, the first Canadian 7-Eleven store opens.

Oh Thank Heaven for 7-Eleven

▲ 1971
7-Eleven enters the European market in England and Scotland. The first 7-Eleven opens in Mexico.

the convenience customer's needs!

▲ 1974
The area licensee for Japan opens its first 7-Eleven store there, beginning a phenomenal decade of growth and representing a major step in international expansion.

▼ 1979
The company achieves its first $1 billion quarter with more than 6,000 7-Eleven stores open. Gasoline accounts for 17 percent of the stores' total sales.

1st billion quarter

▲ 1984
7-Eleven introduces "Super Big Gulp," the first 44 oz. fountain soft drink on the market. It will be copied by competitors many times in coming years. Meanwhile, the company begins widespread introduction of ATMs.

▼ 1991
The revitalization of 7-Eleven begins. The "new" 7-Eleven includes daily delivery of fresh, high-quality food items from Deli Central commissaries and World Ovens bakeries as well as everyday fair prices on all products.

DELI CENTRAL

World Ovens BAKERY

▲ 1996
The company completes the largest store remodeling program in its history. The new look includes wider aisles, better lighting, new layouts and upgraded security systemwide.

CONTENTS

Company Profile

The convenience retailing industry began in 1927 when a Southland Ice Company employee met the needs of his customers by selling bread, milk and eggs from the steps of his ice dock. The name 7-Eleven originated in 1946 when the stores were open from 7 a.m. until 11 p.m. Today, approximately 95 percent of all 7-Eleven stores in the United States and Canada are open 24 hours a day. With 16,314 convenience stores worldwide (see inside front cover for listing of stores by country and by state), 7-Eleven is the premier name in the convenience retailing industry and the largest operator, franchisor and licensor of convenience stores in the world.

IYG Holding Company (IYG) owns 65 percent of Southland's common stock. IYG is 51-percent owned by Ito-Yokado Co., Ltd., the fifth-largest retailer in the world, and 49-percent owned by Seven-Eleven Japan Co., Ltd., the longtime 7-Eleven licensee for Japan.

Southland's common stock is traded on The Nasdaq Stock Market under the ticker symbol SLCM.

Corporate Mission

The Southland Corporation strives to maximize the long-term market value of shareholder equity. Our heritage is 7-Eleven. Its profitable growth and increasing dominance in convenience retailing will remain the core of our existence. We will be successful to the degree that we fulfill the needs of our customers. "What they want, when and where they want it" in a manner that provides added value, engenders loyalty and promotes a lasting relationship. To ensure Southland's continued excellence, we must retain the flexibility to anticipate opportunities and to master all forms of competitive challenge.

Our most important resource is people. Southland excels because of the quality, motivation and loyalty of every member of the Southland family. We are committed to innovation through participative involvement, and to fostering an environment of trust, respect and shared values.

As a responsible corporate citizen, Southland will conduct its business in an ethical manner with the highest integrity, while contributing to the quality of life in the communities it serves.

The ultimate measure of Southland's success is the optimal utilization of our collective resources and the perpetuation of a culture that is distinguished for its clarity of purpose, emphasis on individual responsibility and standards of excellence.

FINANCIAL HIGHLIGHTS

(Dollars in Millions, Except Per-Share Amounts)	1996	1995	1994	1993	1992
FOR THE YEAR:					
Net Sales	$ 6,868.9	$ 6,745.8	$ 6,684.5	$ 6,744.3	$ 7,425.8
Other Income [(1)]	86.4	78.5	74.6	71.3	67.4
Total Revenues [(1)]	6,955.3	6,824.3	6,759.1	6,815.6	7,493.2
Net Earnings (Loss) [(2) (4)]	89.5	270.8	92.0	71.2	(131.4)
Net Earnings (Loss) Per Common Share [(2) (4)]	0.20	0.65	0.22	0.17	(0.32)
Capital Expenditures	194.4	192.2	171.6	195.1	88.6
Interest Expense, Net [(2)]	90.2	85.6	95.0	81.8	97.4
AT YEAR-END:					
Common Shares Outstanding (in thousands)	409,923	409,923	409,923	409,923	410,022
Number of Stores Operated or Franchised by Southland in U.S. and Canada	5,422	5,424	5,630	5,796	6,167
Number of Stores Operated by Licensees or Affiliates in U.S. and Overseas	10,892	9,961	9,067	8,360	7,593
Shareholders of Record	2,834	3,097	3,060	3,130	3,373
Number of Employees (Full-time and Part-time)	29,532	30,523	30,417	32,406	35,646
Shareholders' Equity (Deficit) [(2)]	$ (789.0)	$ (880.8)	$ (1,157.2)	$ (1,248.4)	$ (1,318.8)
Book Value Per Common Share [(2)]	(1.92)	(2.15)	(2.82)	(3.05)	(3.22)
Total Assets	2,039.1	2,081.1	2,000.6	1,990.0	2,039.7

(1) Prior-year amounts have been reclassified to conform to current-year presentation.

(2) The Company is required to prepare its financial statements since completing the 1991 Restructuring in accordance with Statement of Financial Accounting Standards No. 15 (SFAS No. 15). Under SFAS No. 15, the liability for the Company's restructured public debt as recorded on the balance sheet includes all future undiscounted cash payments, both principal and interest. For that reason, no interest expense will be recognized over the life of these securities, although the interest payments are tax deductible. The liability is reduced by the amount of the interest payments at the time they are disbursed. Those cash interest payments, which are paid semiannually, totaled $65 million in 1992, $56 million in 1993, $35 million in 1994, $35 million in 1995 and $22 million in 1996. In November 1995, a portion of the restructured public debt was refinanced, thus reducing the restructured public debt's cash interest payments to $22 million annually beginning in 1996 through 2002, after which payments will decline because of bond maturities.

(3) Includes completed closings and dispositions, as well as losses expected in the near future.

(4) Net earnings (loss) for the years presented include the following:

	1996	1995	1994	1993	1992
Loss on non-store assets sold [(3)]	—	—	—	$ (10.8)	$ (45.0)
Gain on debt redemption	—	$ 103.2	—	99.0	—
Tax benefit from reduction of valuation allowance	—	84.3	$ 30.0	—	—
Cumulative effect of accounting change for postemployment benefits	—	—	—	(16.5)	—
Severance and related costs	—	(13.4)	(7.4)	(7.2)	(17.5)
Gain/(Loss) on closings and dispositions of properties [(3)]	—	—	(3.7)	(48.2)	(44.3)

To Our Shareholders and Bondholders

1996 Highlights

- Increased earnings before taxes for the 4th consecutive year.
- Increased same-store merchandise sales for the 3rd consecutive year.
- Increased merchandise gross profits per store for the 4th consecutive year.
- Improved OSG&A expenses as a percent of sales for the 3rd consecutive year.
- Completed the largest store restoration in 7-Eleven's history.
- Completed the first phase of 7-Eleven's proprietary retail information system (RIS).
- Began testing the electronic point-of-sale equipment to be used in the next phase of RIS.
- Opened 36 new stores.
- Accelerated roll-out of "Deli Central" fresh-food commissaries, "World Ovens" bakeries and combined distribution centers.

Throughout 1996, we continued our focus on revitalizing 7-Eleven by improving each component of our Business Concept: Speed, Selection, Quality, Price and Environment. Last year's operating results validate that our Business Concept is working. Our goal is simple — to assure that each 7-Eleven offers its customers an ever-changing selection of the quality products and services they want, at everyday fair prices, in a quick transaction and in a clean, safe and friendly store environment. The "new" 7-Eleven should be the alternative of choice and its customer base should encompass all segments of the population — not just the traditional c-store customer. While we will continue to refine many of the tactics employed to deliver on the promise of our Business Concept, we have not wavered from the basic principles and strategies developed five years ago. The challenge remains the same, to satisfy the ever-changing wants and needs of the convenience customer, and involves nothing less than constant evolution of the convenience store concept, which The Southland Corporation created 70 years ago.

Last year, we completed the most visible change associated with the "new" 7-Eleven — an extensive four-year remodeling program that affected virtually all of our stores. This new look includes a standard exterior tri-stripe, brighter interior and exterior lighting, a more organized store layout, wider aisles, improved signage and upgraded gasoline facilities. The completion of this program brings us to perhaps the most exciting step in our ongoing efforts to revitalize 7-Eleven — the transition to growing our store base again for the first time in a decade. In 1997, we look forward to opening over 100 new 7-Eleven stores with even greater annual growth over the next few years.

Among the many changes currently underway, and one of the most important, is the implementation of our proprietary retail information

system. Designed to provide the essential item-by-item data needed for improved decision-making, it will also connect every 7-Eleven store to corporate headquarters, regional accounting centers, fresh-food production facilities, distributors and selected manufacturers. Last year, we completed the initial phase of the system with the installation of backroom computers in every store to automate store-level accounting tasks. Realizing its importance in moving our Business Concept to the next level, we have accelerated the implementation of the next phase. In mid-1997, installation of electronic point-of-sale registers with scanning capability and tools designed to assist in order forecasting and product assortment decisions will begin. Upon completion of this phase in 1998, the ability of each 7-Eleven to tailor its product mix to match its customers' needs, reduce out-of-stock conditions through more timely information and manage inventories will be greatly enhanced.

Our recently announced new bank and master lease agreements provide the necessary funding for the next phase of our retail information system and our move into an exciting new era of growth. In addition to increased cash availability, these new facilities lower interest costs through a more favorable rate structure and permit increased capital spending. This commitment from our existing bank group represents a vote of confidence in our Business Concept and belief in the future of the "new" 7-Eleven.

Most important to meeting our customers' needs — and the number one job of our store operators and their associates — is proper order forecasting. At 7-Eleven, product ordering is much more than traditional inventory replenishment. It is the responsibility of each store, on an item-by-item basis, to always be in stock on fast-selling items, properly merchandise high-potential products and delete slow-movers in order to make space for the continual introduction of new items at the earliest possible stages of their product life cycles. As a result, store operators continually try new and different products in order to stay ahead of our customers' constantly changing needs.

Another way 7-Eleven is delivering on its goal of providing its customers an ever-changing selection of quality products is through the concept of combined distribution. Developed with third parties, combined distribution centers (CDCs) provide a system-wide infrastructure to facilitate the daily delivery of many types of "fresh-sensitive" products to our stores. CDCs, which complement the traditional weekly distribution method for dry goods, are able to deliver products such as our proprietary line of Deli Central food items, World Ovens fresh bakery products, dairy products, bread, produce and other perishable items to 7-Eleven stores 365 days a year.

Today, almost half of our stores are receiving daily-delivered fresh merchandise. Daily distribution has many advantages, including the ability of each store to reduce lost opportunities by forecasting orders based on their particular customers' needs. It also supports our everyday-fair-pricing strategy. By combining deliveries from multiple vendors into one delivery per store, significant costs can be driven out of the system. This creates a win/win situation for everyone, from the manufacturer or supplier all the way to the customer.

During the past few years, we have made significant progress toward building a very different 7-Eleven store for the future. Giving customers a better shopping experience than our competition is only a starting point. We must also constantly work at exceeding our customers' expectations.

With 7-Eleven employees, franchisees, suppliers and strategic partners working together and thinking about our business in new and non-traditional ways, we are doing just that. Combine these efforts with the ongoing support of our majority owners and other stakeholders, and we believe that the future of the "new" 7-Eleven is brighter than ever.

Clark Matthews

Clark J. Matthews, II
President and Chief Executive Officer
March 17, 1997

◀ Clark Matthews, President and CEO, communicates with more than 1,200 members of 7-Eleven's management team via weekly videoconferences.

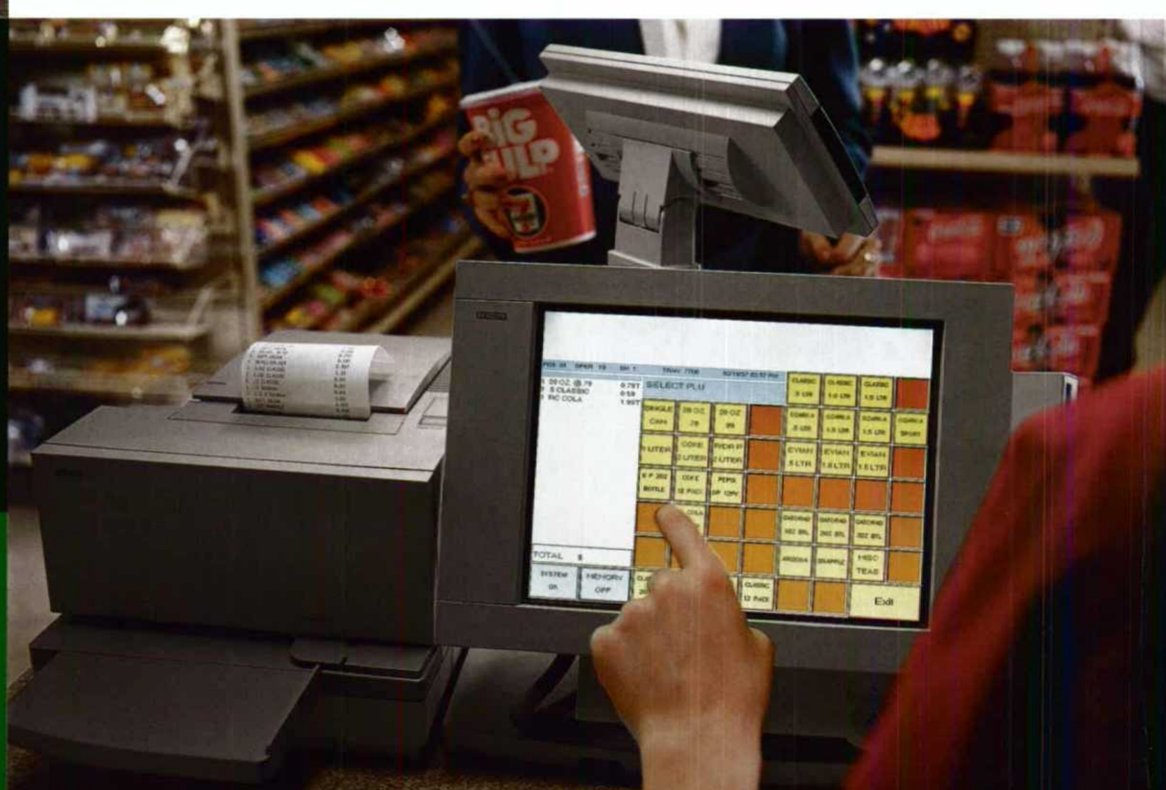
UNDER CONSTRUCTION

After nearly 10 years 7-Eleven is again building new stores. Growth during this time in metro areas where 7-Eleven operates has created a tremendous opportunity. In addition, new stores increase the efficiencies associated with CDCs, fresh-food commissaries and bakeries.

At the end of 1996, 16,314 7-Eleven stores were operating around the world. Of these, 5,422 were franchised or operated by Southland in the U.S. and Canada. Franchisees operate approximately 54 percent of those stores, and their sales are included in the company's 1996 total revenues of $7.0 billion. Area licensees and affiliates operate 620 U.S. stores, as well as 10,272 stores in 18 other countries and two U.S. territories; royalties from these stores are included in Southland's Other Income. Earnings before taxes from 7-Eleven operations increased 29 percent to $130.8 million in 1996, representing the 4th consecutive year of improvement. These results reflect not only 7-Eleven's commitment to sustainable and profitable growth over the long term, but also the progress made within each component of its Business Concept: Speed, Selection, Quality, Price and Environment.

RETAIL INFORMATION SYSTEM

Southland's retail information system (RIS), on which development began in 1994, is designed to enhance and support the ability of 7-Eleven stores to provide superior speed, quality, selection and price. When fully implemented, the system will allow all 7-Eleven stores, company headquarters, regional



accounting centers, fresh-food production facilities, distributors, suppliers and selected manufacturers to communicate electronically and, in many cases, automatically. RIS will provide the timely, in-depth customer and product information needed to enhance item-by-item management and make profitable daily decisions about order forecasting, product assortment and distribution. The resulting improvement in product selection and quality is designed to significantly distinguish 7-Eleven from its competitors. The proprietary system is being developed through a strategic alliance, primarily with NCR, Electronic Data Systems (EDS) and Canmax Retail Systems.

The first phase of the RIS — installation of backroom computers that link each 7-Eleven to corporate headquarters and regional accounting centers — was completed in 1996. This phase automated some of the basic administrative tasks performed by franchisees and store managers each day, thereby saving time and allowing increased focus on order forecasting and customer service. These in-store processors create the foundation for the second phase of RIS — which will provide some of the most sophisticated product movement information available to any retailer. Because of the anticipated positive impact on moving its Business Concept to the next level, Southland is accelerating the roll-out of the next phase, which consists of electronic point-of-sale (EPOS) cash registers with scanners, and electronic ordering. By the end of 1997, over 1,000 stores will have the new registers and scanners, with the remaining stores scheduled to be completed by mid-1998.

The final phase of the current RIS, which will begin in 1998 and be completed in 1999, involves the installation of hand-held Graphic Ordering Terminals (GOTs) in the stores. The GOTs will make electronic ordering more convenient and portable for store operators. Additionally, this phase will offer even more user-friendly information about the sales of

Operating, Selling, General and Administrative Expenses as a Percent of Sales

◄ After two-and-a-half years of development, 7-Eleven has begun installation of its proprietary Retail Information System. This system will build efficiencies into ordering, merchandising and distribution, resulting in better selection and value to customers.

▲ ATMs are in over 90 percent of the 7-Eleven stores in the U.S. and Canada, providing a strong base from which to expand electronic services.

▲ "Collector Series" helped 7-Eleven sell more phone cards than any other retailer in 1996 and promote awareness of this relatively new product.

UNDER CONSTRUCTION

-Eleven recently completed remodeling ver 5,000 stores and the gasoline facilities n over 1,700 stores. These remodels nclude better lighting (both inside and ut), new store layouts and improved ignage. The best ideas from those emodels are incorporated in new tore design.

individual items, weather forecasts, neighborhood events and other information that will improve each store operators' ability to forecast orders more effectively.

The ultimate purpose of RIS is to provide store operators with the best possible information, allowing them to make more effective merchandising decisions that will better satisfy current customers and attract new ones.

STORE DEVELOPMENT

The "new" 7-Eleven look, now found across the U.S., Canada and in many internationally licensed areas, consists of a lighter, brighter store, offering a much more inviting environment for customers and employees. Aisles have been widened, store layouts have been reconfigured, shelves have been lowered and attractive new display cases have been installed to enhance the 7-Eleven customers' shopping experience. In 1996, over 1,000 stores were remodeled, bringing to an end the largest restoration in the company's history. In the last four years 5,200 stores have benefited from these improvements.

Gasoline upgrades, which were a part of the remodel program, included large all-weather canopies and pay-at-the-pump dispensers. At the same time, virtually all remodeled gasoline

facilities were brought into early compliance with stricter federal underground storage tank regulations that are scheduled to go into effect in 1998. The company also completed the installation of security systems with video surveillance equipment and monitored alarms in virtually all stores.

The company's belief in constant improvement means that stores will be periodically remodeled to some degree. The next round of upgrades in 1997 and 1998 will focus on new display units that better showcase the quality and selection of bakery products and ice cream novelties as well as redesigned counter areas to support the new EPOS equipment.

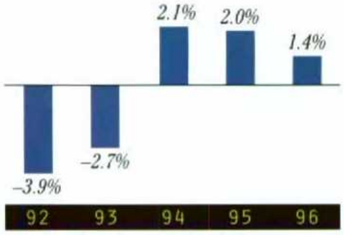
With the completion of the remodeling program in 1996, the company began devoting resources to building new stores. Last year, 36 new 7-Elevens were opened and over 100 are planned for 1997. The company expects the number of yearly new store openings to increase significantly over the next few years, resulting in a growing store base for the first time in 10 years.

New store construction will be concentrated in existing 7-Eleven markets, especially where they will enhance the efficiencies associated with the combined distribution centers (CDCs), Deli Central fresh-food commissaries and World Ovens bakery facilities.

FRESH FOODS, FRESH MERCHANDISE, FRESH IDEAS

Product selection and quality represent the best opportunity for 7-Eleven to satisfy its existing customers. CDCs, owned and operated by third-party distribution experts, are one of the keys to providing selection and quality that exceed customers' expectations in a cost-effective manner.

Daily delivery of fresh products through CDCs is now available in over 2,000 7-Eleven stores. The advantages are already obvious, even to the stores that have been served by



Same Store Merchandise Sales

◄ 7-Eleven just completed remodeling over 5,000 stores, the largest such project in company history.

▲ "Deli Central" products offer a wider selection and better quality of fresh foods than those found in most c-stores.

▲ Coffee and World Ovens pastries – both made to the high 7-Eleven standards – give customers a special reason to stop in each day.

NDER CONSTRUCTION

ustomers not only expect a quality product t a good value, but demand a fast, efficient ansaction as well. Because gasoline is uch an important product, new 7-Eleven tores will have more fueling positions and llow customers to pay at the pump. Inside he new stores customers find an attractive resentation of Deli Central and World vens products.

CDCs for only a few months. The traditional distribution system for "fresh-sensitive" items can be inefficient and inconvenient. In contrast to the distribution of dry goods, which are typically delivered once a week, these short shelf-life items require multiple store-door deliveries by individual vendors several times a week.

Store operators never knew exactly what time of day to expect a delivery, and their focus on customer service was frequently interrupted by the need to receive and check-in deliveries. Customers were inconvenienced by large trucks congesting the parking lots, often during the busiest times of the day, and product assortment or selection was frequently relegated to the route driver who may not know the needs of a specific store's customers or didn't have the needed products on the truck. Now stores can plan on one delivery per day for those participating vendors, made before dawn, when it is least disruptive.

The Deli Central food commissary and World Ovens bakery concepts have been evolving steadily since the first prototypes were built in 1994. Like the CDCs, these food production facilities are dedicated to the 7-Eleven stores in a given area and are operated by carefully chosen third-party operators. All Deli Central and World Ovens items are tasty, high-quality products that are time-stamped with the date and time of production. Most items have a one- or two-day shelf life.

7-Eleven is finding that customers are looking for freshness in a wide variety of categories in addition to ready-to-eat foods. For example, 70 percent of non-subscription magazine sales occur within the first 72 hours after a new issue is released. Under the traditional magazine distribution method, which involves hundreds of dealers, convenience stores often don't receive their shipments until the end of, or even after, this critical 72-hour window. By consolidating the number of suppliers and adding magazines to the list of items that are delivered daily to stores through CDCs, 7-Eleven is capturing some of the opportunity that had previously been ceded to grocery stores and bookstores.

The more efficient product distribution afforded by the CDCs will also enable the company to improve costs. While improvements in product costs have already been obtained, they have been partially offset by product write-offs that naturally result from the learning curve associated with the new system. It is anticipated that costs will decline as expertise in daily order forecasting grows and real-time product movement information becomes available through the RIS. The reduction in costs will enable 7-Eleven to make further progress on its everyday-fair-pricing strategy, while being able to maintain an appropriate margin.

Currently, Deli Central food commissaries offer a total of about three dozen varieties of ready-to-eat entrees, fresh sandwiches, salads and desserts to the stores they serve. Selections vary not only by region and season, but also by store — since operators are tracking these products item-by-item and are learning more each day about the buying patterns of their particular customers.

In addition, several new items were tested successfully in 1996 and will be introduced to most stores in 1997. One example is the addition of cappuccino machines, which will offer

◄ Fresh-food commissaries give 7-Eleven a competitive advantage in food service. This experimental layout presents "Deli Central" products with our popular grill programs.

▲ New looks to visually integrate beverages and snacks with fresh foods are being tested.

▲ New cases attractively present fresh pastries and combine all bakery products.

UNDER CONSTRUCTION

While economics drive business decisions, the excitement generated by new stores — grand opening ceremonies and potential new site development — reinvigorates everyone.

a viable alternative to premium coffee drinks sold in stand-alone coffee shops.

Although the constant introduction of new high-potential products is a key 7-Eleven initiative, one of its most successful proprietary products celebrated its 30th anniversary in 1996 — the Slurpee. More than 5 billion of the icy drinks have been sold in 7-Eleven stores in the U.S. and Canada alone since its introduction in 1966.

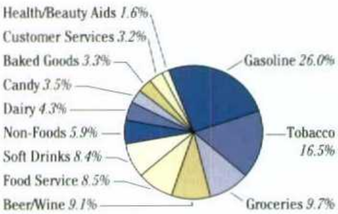
TEAM MERCHANDISING

One way the building of the "new" 7-Eleven has been achieved is through the cooperative efforts of employees, franchisees, 7-Eleven merchandisers, strategic partners and suppliers. More than just using size to negotiate quantity discounts, however, the company is teaming with its suppliers and strategic partners to develop a whole new way of thinking about merchandising. The business model that 7-Eleven is working toward involves a vendor-retailer relationship that is rare in the United States, and virtually nonexistent in the convenience-store segment of retailing.

Key to the success of this model is the realization that 7-Eleven and its vendors will grow profitably only to the extent that they rely on each other's expertise. Working together, Southland

and its vendors and strategic partners have taken a major step forward by looking past traditional barriers that are inherent in convenience retailing. The CDCs are attractive because suppliers recognized that a new method of distribution would benefit them as well as 7-Eleven, and because they would ultimately better serve the customer.

Prepaid long-distance telephone cards are another example of a 3-way win for customers, suppliers and 7-Eleven. Introduced in stores in late 1994, 7-Eleven became the largest retailer of prepaid phone cards in the country within a few months. Customer awareness and trial usage have been promoted through 7-Eleven's "Collectors Series" which include images of players from the National Football League, Major League Baseball and the National Basketball Association. Currently, fewer than half of American consumers are aware of phone cards and a large portion of those that are found out about them at their local 7-Eleven store. Southland believes that this product introduction is typical of the potential retailing power that lies within 7-Eleven. The company plans to begin pursuing truly new products more aggressively in 1997, and to better utilize the merchandising power of its 5,400-store base in North America and 16,000 stores worldwide.



1996

Southland Convenience Store Sales by Category

◄ By the end of 1997 over half of all 7-Eleven stores will be serviced on a daily basis from a combined distribution center.

▲ Fresh products are not limited to food. CDCs allow 7-Eleven to get magazines in the critical first 72 hours of publication — when 70 percent of all retail sales occur.

▲ With the presence of over 16,000 stores worldwide, 7-Eleven is the premier name in convenience retailing.

SELECTED FINANCIAL DATA

(Dollars in Millions, Except Per-Share Data)	1996	1995	1994	1993	1992
	Years Ended December 31				
Net sales	$ 6,868.9	$ 6,745.8	$ 6,684.5	$ 6,744.3	$ 7,425.8
Other income [(a)]	86.4	78.5	74.6	71.3	67.4
Total revenues [(a)]	6,955.3	6,824.3	6,759.1	6,815.6	7,493.2
LIFO charge (credit)	4.7	2.6	3.0	(8.7)	1.5
Depreciation and amortization	185.4	166.4	162.7	154.4	180.3
Interest expense, net	90.2	85.6	95.0	81.8	97.4
Earnings (loss) before income taxes, extraordinary items and cumulative effect of accounting changes	130.8	101.5	73.5	(2.6)	(119.9) [(b)]
Income taxes (benefit)	41.3	(66.1) [(c)]	(18.5) [(d)]	8.7	11.5
Earnings (loss) before extraordinary items and cumulative effect of accounting changes	89.5	167.6	92.0	(11.3)	(131.4)
Net earnings (loss)	89.5	270.8 [(e)]	92.0	71.2 [(f)]	(131.4)
Earnings (loss) per common share (primary and fully diluted):					
Before extraordinary items and cumulative effect of accounting changes	0.20	0.40	0.22	(0.03)	(0.32)
Net earnings (loss)	0.20	0.65	0.22	0.17	(0.32)
Total assets	2,039.1	2,081.1	2,000.6	1,990.0	2,039.7
Long-term debt, including current portion	1,707.4	1,850.6	2,351.2	2,419.9	2,560.4

(a) Prior-year amounts have been reclassified to conform to current-year presentation.

(b) Loss before income taxes, extraordinary items and cumulative effect of accounting changes include a $45 million loss on the sale and closing of the Company's distribution and food processing facilities.

(c) Income taxes (benefit) includes an $84.3 million tax benefit from recognition of the remaining portion of the Company's net deferred tax assets as explained in Note 15 to the Consolidated Financial Statements.

(d) Income taxes (benefit) includes a $30 million tax benefit from recognition of a portion of the Company's net deferred tax assets as explained in Note 15 to the Consolidated Financial Statements.

(e) Net earnings include an extraordinary gain of $103.2 million on debt redemption as explained in Note 8 to the Consolidated Financial Statements.

(f) Net earnings include an extraordinary gain of $99 million on debt redemption and a charge for the cumulative effect of an accounting change for postemployment benefits of $16.5 million.

Some of the matters discussed in this annual report contain forward-looking statements regarding the Company's future business which are subject to certain risks and uncertainties, including competitive pressures, adverse economic conditions and government regulations. These issues, and other factors which may be identified from time to time in the Company's reports filed with the SEC, could cause actual results to differ materially from those indicated in the forward-looking statements.

RESULTS OF OPERATIONS

SUMMARY OF RESULTS OF OPERATIONS

The Company's net earnings for 1996 were $89.5 million, compared to net earnings of $270.8 million in 1995 and $92.0 million in 1994. The Company's operating performance continued to improve, resulting in a 29% increase in 1996 earnings before income taxes and extraordinary gain (see chart below).

	YEARS ENDED DECEMBER 31		
(Dollars in Millions, Except Per-Share Data)	1996	1995	1994
Earnings before income taxes and extraordinary gain	$ 130.8	$ 101.5	$ 73.5
Income tax (expense) benefit	(41.3)	66.1	18.5
Extraordinary gain from partial redemption of the Company's 4½ and 5% debentures in November 1995	—	103.2	—
Net earnings	$ 89.5	$ 270.8	$ 92.0
Net earnings per common share (primary and fully diluted)	$ .20	$ .65	$ .22

The Company's operating improvement in 1996 was primarily due to savings in operating, selling, general and administrative expenses. Although store closings (121 average) resulted in a decline in total merchandise gross profit compared to 1995, average per store merchandise sales and gross profits improved in each quarter in 1996 over 1995.

MANAGEMENT STRATEGIES

Since 1992, the Company has been committed to several key strategies that it believes, over the long term, will provide further differentiation from competitors and allow 7-Eleven to maintain its position as the premier convenience retailer. These strategies include: an upgraded store base; a customer-driven approach to product selection; an everyday-fair-pricing policy on all items; daily delivery of fresh perishable items; introduction of high-quality, ready-to-eat fresh foods; and the implementation of a state-of-the-art retail information system.

For the past four years, the Company has focused on upgrading its store base, both through remodeling existing stores and closing underachieving stores. More recently, this strategy has been expanded through the opening or acquiring of new stores. During 1996, the Company completed the most extensive remodeling program in its history. With its store base now completely remodeled, future upgrade programs will focus on retail information systems, food service and other merchandising programs. Also in 1996, the Company slowed its ten-year decline in operating properties by ending the year with only two fewer stores. Beginning in 1997, new store openings are expected to outpace closings each year, with future expansion initially occurring in existing markets to support the Company's fresh food and combined-distribution initiatives. In recent years, the Company has pruned its store base, closing or disposing of those stores that either could not support its strategies or were not expected to achieve an acceptable level of profitability in the future. As a result, store closings during the past three years totaled 39, 214 and 182 in 1996, 1995 and 1994, respectively.

The customer-driven approach to merchandising focuses on providing the customer an expanded selection of quality products at a good value. This is being accomplished by emphasizing the importance of ordering at the store level, removing slow-moving items and aggressively introducing new products in the early stages of their life cycle. This process will be an ongoing part of managing our business in a continual effort to satisfy the ever-changing preferences of our customers.

The Company's everyday-fair-pricing strategy is designed to provide consistent prices on all items by reducing its reliance on discounting. Following a complete evaluation of product pricing in 1992, the everyday-fair-pricing strategy was introduced, which in turn, allowed some product prices to be lowered, while others were increased to achieve more consistency. Going forward, the Company plans to migrate toward lower retail prices as lower product costs are achieved through contract negotiations or strategic alliances with suppliers and distributors.

Daily delivery of fresh perishable items and high-quality, ready-to-eat foods is another key management strategy. Implementation of this strategy includes third-party development and operation of combined distribution centers ("CDC"), fresh-food commissaries and bakery facilities in many of the Company's markets around the country. The commissary and bakery ready-to-eat items, like fresh sandwiches and pastries, along with goods from multiple vendors such as dairy products, produce and other perishable goods, are "combined" at a distribution center and delivered daily to each store. In addition to providing fresher products, improved in-stock conditions from daily deliveries and quicker

response time on new items, the combined distribution is also intended to provide lower product costs, in part from vendors' savings, through this approach. At the end of 1996, over 2,000 stores were serviced by the CDCs and carried fresh-food products manufactured by the commissaries. Further expansion of these programs is anticipated in 1997 in the following markets: Miami/Fort Lauderdale, Chicago and Long Island. When CDCs in these markets are operational, daily-delivered fresh food will be available to nearly one-half of the Company's stores.

The development of a retail information system ("RIS") began in 1994. The initial phase, completed in early 1996, involved installing in-store processors ("ISP") in each store to automate accounting and other store-level tasks. The current phase involves the installation of point-of-sale registers with scanning capabilities, as well as tools on the ISP to assist with ordering and product assortment, and a hand-held unit for ordering product from the sales floor. After completion of this phase in 1998, the system will provide each store and its suppliers and distributors with on-line information to make better decisions in anticipating customer needs. Management feels that the effective utilization of daily sales data gathered by the system will improve sales through reducing out-of-stock incidents and enhancing each individual store's product mix to better match customers' needs. In addition, the system will assist with monitoring inventories to better control shortage and product write-offs. While implementation costs during the roll-out phase are expected to exceed the short-term benefits, the anticipated long-term benefits of this system, coupled with further reductions in costs resulting from automation, are expected to help the Company reach its goal of sustained profitable growth over the long term.

(Except where noted, all per-store numbers refer to an average of all stores rather than only stores open more than one year.)

SALES

The Company recorded net sales of $6.87 billion for the year ended December 31, 1996, compared to sales of $6.75 billion in 1995 and $6.68 billion in 1994. Over the past three years, sales increases have primarily come from same-store merchandise sales growth, combined with higher gasoline prices. During this time period, growth in total sales was suppressed by the closing of more than 430 underachieving stores (see Management Strategies).

MERCHANDISE SALES GROWTH DATA (PER-STORE)

	Years Ended December 31		
Increase (Decrease) from prior year	1996	1995	1994
U.S. same-store sales	1.4%	2.0%	2.1%
U.S. same-store real growth, excluding inflation	(1.0)%	—	2.8%
7-Eleven inflation (deflation)	2.4%	2.1%	(.7)%

While average per-store merchandise sales results in 1996 were fairly consistent among the various geographical areas, category results were mixed. Categories with significant sales improvement included pre-paid phone cards and services, while traditional convenience store products such as cigarettes, non-alcoholic beverages and candy, which account for almost 40% of merchandise sales, had below average growth. Competition continues to intensify as other retailers rely on price promotions to drive their sales of these products. Additionally, management feels that the Company's ongoing challenge of balancing short-term performance with its long-term objectives contributed to the less-than-desired sales results for the year.

During 1995 average per-store merchandise sales results varied by geographic region. The largest increases occurred in those areas with the highest percentage of completed remodels (Florida 4.8%, Texas/Colorado 4.1%). Conversely, the Southern California area, which included 18% of the Company's domestic stores, experienced a decline of almost 1.5% due to a sluggish economy.

Merchandise sales results experienced deflation during 1994 as a result of cigarette price reductions (on certain premium brands) associated with manufacturers' cost reductions.

Gasoline sales dollars per store increased 7.3%, 4.0% and 8.7% in 1996, 1995 and 1994, respectively. In 1996 and 1995 this increase was mostly due to the average sales price per gallon increasing 12 cents over the two-year period. The increase in gasoline sales dollars per store in 1994 was primarily due to per-store gallonage improvement of 7.8%. Gallon volumes in both 1996 and 1995 did not sustain the high growth levels experienced in 1994 as a result of market factors which affected the way the Company managed its gasoline business.

OTHER INCOME

Other income of $86.4 million for 1996 was $7.9 million higher than 1995 and $11.7 million higher than 1994. The improvement is primarily the result of increased royalty income from licensed operations, combined with increased franchising activities which generated more fees.

GROSS PROFITS

Merchandise Gross Profit Data

	Years Ended December 31		
(Dollars in Millions)	1996	1995	1994
Merchandise Gross Profit	**$ 1,787.7**	**$ 1,790.2**	**$ 1,791.1**
Increase/(decrease) from prior year — all stores:			
Average per-store gross profit dollar change	2.1%	3.1%	1.7%
Margin percentage point change	(.19)	(.01)	(.50)
Average per-store merchandise sales	2.7%	3.1%	3.2%

Total merchandise gross profit dollars have declined slightly in each of the last three years primarily from store closings and a slightly lower margin. However, as a result of per-store sales growth, gross profit dollars per store have consistently improved compared to prior-year results in each quarter over the same period.

During 1996, merchandise margin declined slightly due to three main factors: rising product costs, lower-than-average sales growth of high-margin items and higher product write-offs. Rising product costs and more aggressive retail pricing continue to present a challenge in today's increasingly more competitive environment. Initial costs associated with new, fresh-food products from the further roll-out of the Company's fresh-food program have affected margin. Management is actively working to improve merchandise margin while providing fair and consistent prices.

In 1995, sales of higher-margin categories like pre-paid phone cards and services performed well enough to offset cost increases that could not be passed on to the consumer for competitive reasons. The decline in margin during 1994 was primarily due to increased costs for disposal of slow-moving merchandise, combined with a pricing test in which the Company tested lower prices in certain parts of the country as part of a more aggressive everyday-fair-pricing strategy.

Gasoline Gross Profit Data

	Years Ended December 31		
(Dollars in Millions)	1996	1995	1994
Gasoline Gross Profit	**$ 188.1**	**$ 192.9**	**$ 199.6**
Increase/(decrease) from prior year:			
Average per-store gross profit dollar change	(1.4)%	(3.3)%	8.2%
Margin point change (in cents per gallon)	(.17)	(.60)	.06
Average per-store gas gallonage	(.1)%	1.0%	7.8%

In 1996, gasoline gross profits declined $4.8 million from the levels achieved in 1995. Lower margins (in cents per gallon) and gasoline gallonage, during 1996, were the result of market conditions that kept wholesale costs high for much of the year while competitive pressures kept retail prices in check. The strong 1994 results were aided by favorable market conditions created by the federally mandated fuel reformulation program which kept the margins unusually high in the fourth quarter of 1994.

OPERATING, SELLING, GENERAL AND ADMINISTRATIVE EXPENSES ("OSG&A")

	Years Ended December 31		
(Dollars in Millions)	1996	1995	1994
Total operating, selling, general and administrative expenses	$ 1,841.2	$ 1,874.5	$ 1,896.8
Ratio of OSG&A to sales	26.8%	27.8%	28.4%
Decrease in OSG&A compared to prior year*	$ (33.3)	$ (22.3)	$ (143.3)

**1993 included $48.2 million loss for store closings and dispositions of properties and a $10.8 million loss for disposition of Citijet, a fixed-base operation at Dallas Love Field Airport. Excluding these unusual items, the decrease in 1994 would have been $84.3 million.*

OSG&A expenses, and the ratio to sales, have declined in each of the last three years. In 1996, despite the incremental costs of the retail information system initiatives which exceeded $7 million, OSG&A expenses declined over $33 million. The largest item contributing to the improvement was lower insurance costs. Based upon favorable claims experience, the Company lowered its store insurance and employee benefit reserves. Other factors aiding the comparison included the absence of a significant restructuring charge compared to a charge of $13.4 million in 1995, declines in environmental remediation expenses, savings from reductions in force and lower expenses from having fewer stores. Management expects future periods' expenses and the ratio to sales to increase with the continued roll-out of the retail information system.

The Company continues to review the functions necessary to enable its stores to respond faster and more cost efficiently to rapidly changing customer needs and preferences. In conjunction with this review, management continues to realign and reduce personnel and office facilities, in order to eliminate non-essential costs, while devoting resources to the implementation of its retail information system and other strategic initiatives (see Management Strategies).

The majority of the decrease in OSG&A expenses in 1995 and 1994 resulted from cost savings realized from reductions in force, combined with the effect of having fewer stores (see Management Strategies). In December 1995, the Company accrued $13.4 million

for severance costs and realignment of office space. These reductions were substantially complete in 1996, and changes in estimates from the original accrual did not have a material impact on 1996 earnings. In December 1994, the Company accrued $7.4 million for severance costs and office reductions. The employee terminations were completed in 1995, while the office realignments were completed in 1996. Changes from 1994's original accrual did not have a material impact on 1995 earnings.

INTEREST EXPENSE, NET

Net interest expense increased $4.6 million in 1996 compared to 1995 due to lower interest income, combined with higher interest expense from the Convertible Quarterly Income Debt Securities ("Convertible Debt") due 2010 which were issued in November 1995. The lower interest income was primarily the result of a new money order agreement that eliminated interest income from the funding arrangement; however, it provided lower cost of goods and operating costs, which more than offset the impact of the lost interest. Interest on the Convertible Debt was almost entirely offset by reduced principal balances and lower rates on floating rate debt. As discussed further in Note 8 to the Consolidated Financial Statements, in accordance with SFAS No. 15, no interest expense is recognized on the Company's public debt securities, as the cash interest payments are charged against the recorded principal balance of such securities.

Approximately 35% of the Company's debt contains floating rates that will be unfavorably impacted by rising interest rates. The weighted average interest rate for such debt was 5.83% for 1996 versus 6.62% and 5.51% for 1995 and 1994, respectively. The Company expects net interest expense in 1997 to remain relatively flat due to higher borrowings to finance new store development, offset by increased capitalized interest and a .6% reduction in the cost of borrowing that the Company negotiated with the lenders in its new, unsecured bank debt credit agreement ("New Credit Agreement") (see Liquidity and Capital Resources).

The Company's net interest expense in 1995 decreased $9.4 million compared to 1994. Most of the savings related to non-cash interest, which declined due to the refinancing of the term loans under the secured senior bank debt credit agreement ("Old Credit Agreement") in December 1994 and the extension of the repayment of the debt relating to the Company's headquarters facilities (Cityplace) at a lower interest rate in February 1995. The adverse impact of the 1.1% rise in the weighted average interest rate on the Company's floating rate debt during 1995 increased interest expense approximately $8 million. However, the 1.5% reduction in the margin that the Company negotiated with its bank lenders in the refinancing in late 1994 offset a portion ($5 million) of this increase.

INCOME TAXES

The Company recorded tax expense in 1996 of $41.3 million, compared to tax benefits in 1995 and 1994 of $66.1 million and $18.5 million, respectively. Higher income taxes were the result of the rise in earnings before income taxes and extraordinary items, which have increased by 29% and 38% for the year-to-year comparisons of 1996 vs. 1995 and 1995 vs. 1994. Tax benefits in 1995 and 1994 were the result of recognition of deferred tax assets. During the fourth quarter of 1995, due to the Company's demonstrated ability to produce higher levels of taxable income, the remaining portion of the valuation allowance for deferred taxes was reversed, producing an $84.3 million benefit. During the fourth quarter of 1994, as a result of the Company's anticipated 1995 taxable earnings, the valuation allowance was reduced $30 million.

EXTRAORDINARY GAIN

On November 22, 1995, the Company completed a tender offer for 40% of the face value of both its 5% First Priority Senior Subordinated Debentures due December 15, 2003 ($180.6 million) and 4½% Second Priority Senior Subordinated Debentures-Series A ($82.7 million) due June 15, 2004 (collectively, the "Debentures"). Under the terms of the offer the final clearing prices were $840.00 and $786.00 for the 5% and 4½% Debentures, respectively, per $1,000 face amount, resulting in a cash outlay by the Company of $216.7 million. To finance the purchase of the Debentures, the Company issued $300 million in Convertible Debt to Ito-Yokado Co., Ltd., and Seven-Eleven Japan Co., Ltd., the joint owners of IYG Holding Company, which is the Company's majority shareholder. The Company recognized a $103.2 million after-tax extraordinary gain on the purchase of the Debentures in the fourth quarter of 1995. The gain resulted from purchasing the Debentures below their face value and from retiring the future undiscounted interest payments on that portion of the Debentures that were purchased. As a result of the Company's financial restructuring in 1991, SFAS No. 15 required the Company to include its future undiscounted interest payments on the Debentures in the carrying value of the debt on the balance sheet.

Liquidity and Capital Resources

The majority of the Company's working capital is provided from three sources: i) cash flows generated from its operating activities; ii) a $400 million commercial paper facility (guaranteed by Ito-Yokado Co., Ltd.); and iii) short-term seasonal borrowings of up to $400 million (reduced by outstanding letters of credit) under its revolving credit facility. The Company believes that operating

activities, coupled with available short-term working capital facilities, will provide sufficient liquidity to fund current operating and capital expenditure programs, as well as to service debt requirements.

In February 1997, the Company entered into a New Credit Agreement, refinancing its old term loan ($225 million), revolving credit facility and letters of credit ($150 million each), all of which were scheduled to mature on December 31, 1999, with a new term loan facility ("Term Loan") and revolving credit facility. The Term Loan ($225 million) has scheduled quarterly repayments of $14.1 million commencing March 31, 1998 through December 31, 2001. The new revolving credit facility ($400 million) expires February 2002 and allows for revolving borrowings ("Revolver"), and for issuance of letters of credit not to exceed $150 million. Interest on the Term Loan and Revolver is based on a variable rate equal to the administrative agent bank's base rate or, at the Company's option, a rate equal to a reserve-adjusted Eurodollar rate plus .225% per year for drawn amounts. The new agreement requires letter of credit fees to be paid quarterly at .325% per year on the outstanding amount. In addition, a facility fee of .15% per year is payable quarterly on the total amount available under the New Credit Agreement, as such amount is reduced from time to time. The cost of borrowings and letters of credit under the New Credit Agreement represents a decrease of .6% and .45% per year, respectively, from the Old Credit Agreement.

The Company has received commitments subject to final documentation, for a Master Lease Facility ("MLF") in an amount not to exceed $115 million. The MLF is expected to close in April of 1997 and is intended to finance a complete integrated point-of-sale system which is scheduled to be rolled out over the subsequent six quarters (see Management Strategies). The lease payment on the MLF will be based on a variable rate equal to the Eurodollar rate plus a blended all-inclusive spread of .46% per year. The MLF is expected to have a two-year noncancellable term with semiannual options to renew for up to an additional three years. Based upon current roll-out schedules, it is anticipated that the commitment under the MLF will be fully utilized by the end of 1998.

The New Credit Agreement contains certain financial and operating covenants requiring, among other things, the maintenance of certain financial ratios, including interest and rent coverage, fixed-charge coverage and senior indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA"). The covenant levels established by the New Credit Agreement generally require continuing improvement in the Company's financial condition. The covenants in the New Credit Agreement, when compared to the Old Credit Agreement, allow the Company more flexibility in its borrowing levels and capital expenditures.

For the period ended December 31, 1996, the Company was in compliance with all of the covenants required under the Old Credit Agreement, including compliance with the principal financial and operating covenants (calculated over the latest 12-month period) as follows:

		Requirements	
Covenants	Actuals	Minimum	Maximum
Interest coverage*	3.44 to 1.0	3.00 to 1.0	—
Fixed charge coverage	1.11 to 1.0	0.90 to 1.0	—
Senior indebtedness to EBITDA	3.07 to 1.0	—	3.50 to 1.0

**includes effects of the SFAS No. 15 interest payments.*

In 1996, the Company repaid $140.4 million of debt, which included $75.0 million representing the quarterly installments due in 1996 under the Old Credit Agreement, $27.8 million for principal payments on the Company's yen-denominated loan (secured by the royalty income stream from its area licensee in Japan) and $22.4 million for SFAS No. 15 interest. Outstanding balances at December 31, 1996, for the commercial paper, the Term Loan and the Revolver, were $398.1 million, $225.0 million and zero, respectively. As of December 31, 1996, outstanding letters of credit issued pursuant to the Old Credit Agreement totaled $79.2 million.

CASH FROM OPERATING ACTIVITIES

Net cash provided by operating activities was $261.0 million for 1996, compared to $236.2 million in 1995 and $271.6 million in 1994 (see Results of Operations section).

CAPITAL EXPENDITURES

During 1996, net cash used in investing activities consisted primarily of payments of $194.4 million for property and equipment, the majority of which was used for remodeling stores, the continued implementation of a retail information system, upgrading retail gasoline facilities, replacing equipment and complying with environmental regulations.

The Company expects 1997 capital expenditures, excluding lease commitments, to be approximately $325 million. Capital expenditures are being used to develop or acquire new stores, upgrade store facilities, further implement a retail information system, replace equipment, upgrade gasoline facilities and comply with environmental regulations. The amount of expenditures during the year will be materially impacted by the proportion of new store development funded through working capital versus leases. Most leases related to new store construction would contain initial terms of 15-20 years with typical option renewal periods.

CAPITAL EXPENDITURES — GASOLINE EQUIPMENT

The Company incurs ongoing costs to comply with federal, state and local environmental laws and regulations primarily relating to underground storage tank ("UST") systems. The Company anticipates it will spend approximately $15 million in 1997 on capital improvements required to comply with environmental regulations relating to USTs, as well as above-ground vapor recovery equipment at store locations, and approximately an additional $20 million on such capital improvements from 1998 through 2000.

ENVIRONMENTAL

In December 1996, the Company adopted the American Institute of Certified Public Accountants' recently issued Statement of Position ("SOP") No. 96-1, "Environmental Remediation Liabilities." SOP No. 96-1 provides guidance on specific accounting issues that are present in the recognition, measurement and disclosure of environmental remediation liabilities and is required for fiscal years beginning after December 15, 1996.

In December 1988, the Company closed its chemical manufacturing facility in New Jersey. As a result, the Company is required to conduct environmental remediation at the facility and has submitted a clean-up plan to the New Jersey Department of Environmental Protection (the "State"), which provides for remediation of the site for approximately a three- to- five-year period, as well as continued groundwater treatment for a projected 20-year period. While the Company has recently received conditional approval of its clean-up plan, the Company must supply additional information to the State before the plan can be finalized. The Company has recorded undiscounted liabilities representing its best estimates of the clean-up costs of $30.9 million at December 31, 1996. In 1991, the Company and the former owner of the facility executed a final settlement pursuant to which the former owner agreed to pay a substantial portion of the clean-up costs. Based on the terms of the settlement agreement and the financial resources of the former owner, the Company has recorded a receivable of $18.2 million at December 31, 1996.

Additionally, the Company accrues for the anticipated future costs and the related probable state reimbursement amounts for remediation activities at its existing and previously operated gasoline sites where releases of regulated substances have been detected. At December 31, 1996, the Company's estimated undiscounted liability for these sites was $46.5 million. This estimate is based on the Company's prior experience with gasoline sites and its consideration of such factors as the age of the tanks, location of tank sites and experience with contractors who perform environmental assessment and remediation work. The Company anticipates that substantially all of the future remediation costs for detected releases at these sites as of December 31, 1996, will be incurred within the next five years.

Under state reimbursement programs, the Company is eligible to receive reimbursement for a portion of future remediation costs, as well as remediation costs previously paid. Accordingly, at December 31, 1996, the Company has recorded a net receivable of $50.0 million for the estimated probable state reimbursements. The Company increased the estimated net environmental cost reimbursements at the end of 1996 by approximately $7.5 million as a result of completing a review of state reimbursement programs. In assessing the probability of state reimbursements, the Company takes into consideration each state's fund balance, revenue sources, existing claim backlog, status of clean-up activity and claim ranking systems. As a result of these assessments, the recorded receivable amount is net of an allowance of $9.5 million. While there is no assurance of the timing of the receipt of state reimbursement funds, based on its experience, the Company expects to receive the majority of state reimbursement funds, except from California, within one to three years after payment of eligible remediation expenses, assuming that the state administrative procedures for processing such reimbursements have been fully developed. The Company estimates that it may take one to eight years to receive reimbursement funds from California. Therefore, the portion of the recorded receivable amounts that relate to sites where remediation activities have been completed have been discounted at 7% to reflect their present value. As a result of the adoption of SOP No. 96-1, the 1996 recorded receivable amount is also net of a discount of $6.4 million.

The estimated future assessment and remediation expenditures and related state reimbursement amounts could change within the near future as governmental requirements and state reimbursement programs continue to be implemented or revised.

Consolidated Balance Sheets

(Dollars in Thousands, Except Per-Share Data)	December 31 1996	December 31 1995
Assets		
Current assets:		
Cash and cash equivalents	$ 36,494	$ 43,047
Accounts receivable	109,413	107,224
Inventories	109,050	102,020
Other current assets	95,943	103,816
Total current assets	350,900	356,107
Property and equipment	1,349,839	1,335,783
Other assets	338,409	389,227
	$ 2,039,148	$ 2,081,117
Liabilities and Shareholders' Equity (Deficit)		
Current liabilities:		
Trade accounts payable	$ 211,060	$ 195,154
Accrued expenses and other liabilities	297,246	329,429
Commercial paper	98,055	50,198
Long-term debt due within one year	68,571	145,346
Total current liabilities	674,932	720,127
Deferred credits and other liabilities	214,343	236,545
Long-term debt	1,638,828	1,705,237
Convertible quarterly income debt securities	300,000	300,000
Commitments and contingencies		
Shareholders' equity (deficit):		
Common stock, \$.0001 par value; 1,000,000,000 shares authorized; 409,922,935 shares issued and outstanding	41	41
Additional capital	625,574	625,574
Accumulated deficit	(1,414,570)	(1,506,407)
Total shareholders' equity (deficit)	(788,955)	(880,792)
	$ 2,039,148	$ 2,081,117

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS

(Dollars in Thousands, Except Per-Share Data)	Years Ended December 31 1996	1995	1994
Revenues:			
Net sales (including $961,987, $977,828 and $972,030 in excise taxes)	$ 6,868,912	$ 6,745,820	$ 6,684,495
Other income	86,351	78,458	74,624
	6,955,263	6,824,278	6,759,119
Costs and expenses:			
Cost of goods sold	4,893,061	4,762,707	4,693,826
Operating, selling, general and administrative expenses	1,841,174	1,874,460	1,896,827
Interest expense, net	90,204	85,582	94,970
	6,824,439	6,722,749	6,685,623
Earnings before income taxes and extraordinary gain	130,824	101,529	73,496
Income taxes (benefit)	41,348	(66,065)	(18,500)
Earnings before extraordinary gain	89,476	167,594	91,996
Extraordinary gain on debt redemption (net of tax effect of $8,603 in 1995)	—	103,169	—
Net earnings	$ 89,476	$ 270,763	$ 91,996
Earnings per common share (primary and fully diluted):			
Before extraordinary gain	$ .20	$ .40	$ .22
Extraordinary gain	—	.25	—
Net earnings	$ .20	$ .65	$ .22

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity (Deficit)

(Dollars in Thousands, Except Share Amounts)	Common Stock Shares	Common Stock Amount	Additional Capital	Accumulated Deficit	Total Shareholders' Equity (Deficit)
Balance, January 1, 1994	409,922,935	$ 41	$ 625,574	$ (1,873,965)	$ (1,248,350)
Net earnings	—	—	—	91,996	91,996
Foreign currency translation adjustments	—	—	—	(877)	(877)
Balance, December 31, 1994	409,922,935	41	625,574	(1,782,846)	(1,157,231)
Net earnings	—	—	—	270,763	270,763
Foreign currency translation adjustments	—	—	—	(2,470)	(2,470)
Other	—	—	—	8,146	8,146
Balance, December 31, 1995	409,922,935	41	625,574	(1,506,407)	(880,792)
Net earnings	—	—	—	89,476	89,476
Foreign currency translation adjustments	—	—	—	(258)	(258)
Other	—	—	—	2,619	2,619
Balance, December 31, 1996	409,922,935	$ 41	$ 625,574	$ (1,414,570)	$ (788,955)

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

The Southland Corporation and Subsidiaries

(Dollars in Thousands)	1996	1995	1994
	Years Ended December 31		
Cash flows from operating activities:			
Net earnings	$ 89,476	$ 270,763	$ 91,996
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Extraordinary gain on debt redemption	—	(103,169)	—
Depreciation and amortization of property and equipment	166,347	147,423	143,670
Other amortization	19,026	19,026	19,026
Deferred income taxes	23,790	(84,269)	(30,000)
Noncash interest expense	1,746	1,974	11,384
Other noncash expense (income)	182	(409)	614
Net loss on property and equipment	1,714	7,274	7,504
Decrease (increase) in accounts receivable	4,824	(2,708)	(3,066)
(Increase) decrease in inventories	(7,030)	(552)	7,895
Decrease (increase) in other assets	386	(1,053)	24,273
Decrease in trade accounts payable and other liabilities	(39,421)	(18,083)	(1,729)
Net cash provided by operating activities	261,040	236,217	271,567
Cash flows from investing activities:			
Payments for purchase of property and equipment	(194,373)	(192,221)	(171,636)
Proceeds from sale of property and equipment	14,499	15,720	15,867
Other	9,588	2,770	(5,552)
Proceeds from sale of distribution and food center assets	—	—	6,305
Net cash used in investing activities	(170,286)	(173,731)	(155,016)
Cash flows from financing activities:			
Proceeds from commercial paper and revolving credit facilities	4,292,215	4,171,927	4,451,774
Payments under commercial paper and revolving credit facilities	(4,249,134)	(4,256,918)	(4,418,693)
Proceeds from issuance of long-term debt	—	—	300,000
Principal payments under long-term debt agreements	(140,388)	(289,372)	(400,580)
Proceeds from issuance of convertible quarterly income debt securities	—	300,000	—
Debt issuance costs	—	(4,364)	(3,250)
Net cash used in financing activities	(97,307)	(78,727)	(70,749)
Net (decrease) increase in cash and cash equivalents	(6,553)	(16,241)	45,802
Cash and cash equivalents at beginning of year	43,047	59,288	13,486
Cash and cash equivalents at end of year	$ 36,494	$ 43,047	$ 59,288
Related disclosures for cash flow reporting:			
Interest paid, excluding SFAS No. 15 Interest	$ (100,777)	$ (97,945)	$ (98,157)
Net income taxes paid	$ (18,918)	$ (34,674)	$ (7,810)

See notes to consolidated financial statements.

YEARS ENDED DECEMBER 31, 1996, 1995 AND 1994

1. ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The Southland Corporation and subsidiaries (the "Company") is owned approximately 65% by IYG Holding Company, which is jointly owned by Ito-Yokado Co., Ltd. ("IY") and Seven-Eleven Japan Co., Ltd. ("SEJ").

The consolidated financial statements include the accounts of The Southland Corporation and its subsidiaries. Intercompany transactions and account balances are eliminated. Prior-year and quarterly amounts are reclassified to conform to the current-year presentation.

The Company operates more than 5,400 7-Eleven and other convenience stores in the United States and Canada. Area licensees, or their franchisees, and affiliates operate approximately 10,800 additional 7-Eleven convenience stores in certain areas of the United States, in 18 foreign countries and in the U.S. territories of Guam and Puerto Rico. The Company's net sales are comprised of sales of groceries, take-out foods and beverages, gasoline (at certain locations), dairy products, non-food merchandise, specialty items and services.

Net sales and cost of goods sold of stores operated by franchisees are consolidated with the results of Company-operated stores. Net sales of stores operated by franchisees are $2,860,768,000, $2,832,131,000 and $2,820,685,000 from 2,927, 2,896 and 2,962 stores for the years ended December 31, 1996, 1995 and 1994, respectively.

Under the present franchise agreements, initial franchise fees are recognized in income currently and are generally calculated based upon gross profit experience for the store or market area. These fees cover certain costs including training, an allowance for travel, meals and lodging for the trainees and other costs relating to the franchising of the store.

The gross profit of the franchise stores is split between the Company and its franchisees. The Company's share of the gross profit of franchise stores is its continuing franchise fee, generally ranging from 50% to 58% of the gross profit of the store, which is charged to the franchisee for the license to use the 7-Eleven operating system and trademarks, for the lease and use of the store premises and equipment, and for continuing services provided by the Company. These services include merchandising, advertising, recordkeeping, store audits, contractual indemnification, business counseling services and preparation of financial statements. The gross profit earned by the Company's franchisees of $516,884,000, $515,610,000 and $517,955,000 for the years ended December 31, 1996, 1995 and 1994, respectively, is included in the Consolidated Statements of Earnings as operating, selling, general and administrative expenses ("OSG&A").

Sales by stores operated under domestic and foreign area license agreements are not included in consolidated revenues. All fees or royalties arising from such agreements are included in other income. Initial fees, which have been immaterial, are recognized when the services required under the agreements are performed.

OTHER INCOME

Other income is primarily area license royalties and franchise fee income. The area license royalties include amounts from area license agreements with SEJ of approximately $47,000,000, $44,000,000 and $42,000,000 for the years ended December 31, 1996, 1995 and 1994, respectively.

OPERATING, SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Buying and occupancy expenses are included in OSG&A.

INTEREST EXPENSE

Interest expense is net of interest income of $10,649,000, $16,975,000 and $13,618,000 for the years ended December 31, 1996, 1995 and 1994, respectively.

INCOME TAXES

Income taxes are determined using the liability method, where deferred tax assets and liabilities are recognized for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets include tax carryforwards and are reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investment instruments purchased with maturities of three months or less to be cash equivalents. Cash and cash equivalents include temporary cash investments of $12,252,000 and $8,787,000 at December 31, 1996 and 1995, respectively, stated at cost, which approximates market. In addition, at December 31, 1996, cash and cash equivalents include $8,045,000 of restricted cash related to unremitted money order collections.

INVENTORIES

Inventories are stated at the lower of cost or market. Cost is generally determined by the LIFO method for stores in the United States and by the FIFO method for stores in Canada.

DEPRECIATION AND AMORTIZATION

Depreciation of buildings and equipment is based upon the estimated useful lives of these assets using the straight-line method. Amortization of capital leases, improvements to leased properties and favorable leaseholds is based upon the remaining terms of the leases or the estimated useful lives, whichever is shorter.

Foreign and domestic area license royalty intangibles were recorded in 1987 at the fair value of future royalty payments and are being amortized over 20 years using the straight-line method. The 20-year life is less than the estimated lives of the various royalty agreements, the majority of which are perpetual.

STORE CLOSINGS

Provision is made on a current basis for the write-down of identified owned-store closings to their net realizable value. For identified leased-store closings, leasehold improvements are written down to their net realizable value and a provision is made on a current basis if anticipated expenses are in excess of expected sublease rental income.

STOCK-BASED COMPENSATION

As of January 1996, the Company adopted the disclosure-only requirements of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," and will therefore continue to apply the provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees."

BUSINESS SEGMENT

The Company operates in a single business segment — the operating, franchising and licensing of convenience food stores, primarily under the 7-Eleven name.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. ACCOUNTS RECEIVABLE

	DECEMBER 31	
(Dollars in Thousands)	1996	1995
Trade accounts receivable	$ 37,690	$ 40,647
Franchisee accounts receivable	46,345	43,556
Environmental cost reimbursements (net of long-term portion of $53,886 and $64,034) — see Note 14	14,366	17,654
Other accounts receivable	16,021	10,225
	114,422	112,082
Allowance for doubtful accounts	(5,009)	(4,858)
	$ 109,413	$ 107,224

3. INVENTORIES

Inventories stated on the LIFO basis that are included in inventories in the accompanying Consolidated Balance Sheets were $66,272,000 and $62,705,000 at December 31, 1996 and 1995, respectively, which is less than replacement cost by $31,418,000 and $30,907,000, respectively.

4. Other Current Assets

(Dollars in Thousands)	December 31 1996	1995
Prepaid expenses	$ 20,298	$ 17,775
Deferred tax assets	70,438	78,665
Other	5,207	7,376
	$ 95,943	$ 103,816

5. Property and Equipment

(Dollars in Thousands)	December 31 1996	1995
Cost:		
Land	$ 453,233	$ 461,585
Buildings and leaseholds	1,310,927	1,274,651
Equipment	790,718	697,673
Construction in process	32,614	32,725
	2,587,492	2,466,634
Accumulated depreciation and amortization	(1,237,653)	(1,130,851)
	$ 1,349,839	$ 1,335,783

In January 1996, the Company adopted SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets." The statement establishes accounting standards for the impairment of long-lived assets to be held and used and for long-lived assets to be disposed of. The adoption of SFAS No. 121 did not have a material effect on the Company's earnings.

6. Other Assets

(Dollars in Thousands)	December 31 1996	1995
Japanese license royalty intangible (net of accumulated amortization of $149,004 and $132,988)	$ 169,497	$ 185,513
Other license royalty intangibles (net of accumulated amortization of $26,586 and $23,750)	30,018	32,854
Environmental cost reimbursements — see Note 14	53,886	64,034
Deferred tax assets	13,158	30,396
Other (net of accumulated amortization of $6,694 and $5,023)	71,850	76,430
	$ 338,409	$ 389,227

7. Accrued Expenses and Other Liabilities

(Dollars in Thousands)	December 31 1996	1995
Accrued insurance	$ 79,253	$ 83,068
Accrued payroll	45,256	43,025
Accrued taxes, other than income	37,967	40,710
Accrued environmental costs — see Note 14	23,654	40,659
Other	111,116	121,967
	$ 297,246	$ 329,429

Other includes accounts payable to The Southland Corporation Employees' Savings and Profit Sharing Plan (see Note 12) for contributions and contingent rent payables of $15,641,000 and $13,635,000 as of December 31, 1996 and 1995, respectively.

The Company continues to review the functions necessary to enable its stores to respond faster, more creatively and more cost efficiently to rapidly changing customer needs and preferences. To accomplish this goal, the Company continues to realign and reduce personnel and office facilities.

In December 1995 and 1994, the Company accrued $13,415,000 and $7,405,000, respectively, for severance benefits for employees terminated and for changes in office facilities. The 1995 employee terminations and office realignments were substantially completed in 1996, and changes in estimates from the original accruals did not have a material impact on 1996 or 1995 earnings.

8. Debt

(Dollars in Thousands)	December 31 1996	1995
Bank Debt Term Loans	$ 225,000	$ 300,000
Commercial paper	300,000	300,000
5% First Priority Senior Subordinated Debentures due 2003	364,056	377,558
4½% Second Priority Senior Subordinated Debentures (Series A) due 2004	165,387	170,952
4% Second Priority Senior Subordinated Debentures (Series B) due 2004	24,396	25,146
12% Second Priority Senior Subordinated Debentures (Series C) due 2009	54,468	57,082
6¼% Yen Loan	201,447	229,243
7½% Cityplace Term Loan due 2005	282,606	286,949
Capital lease obligations	82,833	90,852
Other	7,206	12,801
	1,707,399	1,850,583
Less long-term debt due within one year	68,571	145,346
	$ 1,638,828	$ 1,705,237

Bank Debt

At December 31, 1996, the Company was obligated to a group of lenders under a credit agreement that included term loans and a revolving credit facility. In February 1997, the Company repaid all amounts due under that credit agreement with proceeds from a group of lenders under a new, unsecured credit agreement ("Credit Agreement"). The new Credit Agreement includes a $225 million term loan, which replaced the previous term loan of equal amount, and a $400 million revolving credit facility. A sublimit of $150 million for letters of credit is included in the revolving credit facility. The amount of borrowing availability represents an increase of $100 million over the previous facility. In addition, to the extent outstanding letters of credit are less than the $150 million maximum, the excess availability can be used for additional borrowings under the revolving credit facility.

The Company has also obtained commitments from the same group of lenders for up to $115 million of lease financing that will be used primarily for electronic point-of-sale equipment associated with the Company's retail information system. The master lease arrangement is expected to close in April 1997.

The term loan matures on December 31, 2001, and has no payments due in 1997. Thereafter, the loans will be repaid in 16 quarterly installments of $14,062,500 commencing March 31, 1998. Upon expiration of the new revolving credit facility in February 2002, all the then-outstanding letters of credit must expire and may need to be replaced, and all other amounts then outstanding will be due and payable in full. At December 31, 1996, outstanding letters of credit under the previous facility totaled $79,207,000, and no revolving loans were outstanding.

Interest on the new term loan and borrowings under the revolving credit facility is generally payable quarterly and is based on a variable rate equal to the administrative agent bank's base rate or, at the Company's option, at a rate equal to a reserve-adjusted Eurodollar rate plus .225% per year. A fee of .325% per year on the outstanding amount of letters of credit is required to be paid quarterly. In addition, a facility fee of .15% per year is charged on the aggregate amount of the credit agreement facility, as such amount is reduced from time to time, and is payable quarterly. The cost of borrowings and letters of credit under the new Credit Agreement represents a decrease of .6% and .45% per year, respectively, from the previous credit agreement. The weighted-average interest rate on the term loan outstanding under the previous credit agreement at December 31, 1996 and 1995 was 6.3% and 6.9%, respectively.

The Credit Agreement contains various financial and operating covenants which require, among other things, the maintenance of certain financial ratios including interest and rent coverage, fixed-charge coverage and senior indebtedness to earnings before interest, income taxes, depreciation and amortization. The Credit Agreement also contains various covenants which, among other things, (a) limit the Company's ability to incur or guarantee indebtedness or other liabilities other than under the Credit Agreement, (b) restrict the Company's ability to engage in asset sales and sale/leaseback transactions, (c) restrict the types of investments the Company can make and (d) restrict the Company's ability to pay cash dividends, redeem or prepay principal and interest on any subordinated debt and certain senior debt.

Commercial Paper

The Company has a facility that provides for the issuance of up to $400 million in commercial paper. At both December 31, 1996 and 1995, $300 million of the respective $398,055,000 and $350,198,000 outstanding principal amounts, net of discount, was classified as long-term debt since the Company intends to maintain at least this

amount outstanding during the next year. Such debt is unsecured and is fully and unconditionally guaranteed by IY. IY has agreed to continue its guarantee of all commercial paper issued through 1998. While it is not anticipated that IY would be required to perform under its commercial paper guarantee, in the event IY makes any payments under the guarantee, the Company and IY have entered into an agreement by which the Company is required to reimburse IY subject to restrictions in the Credit Agreement. The weighted-average interest rate on commercial paper borrowings outstanding at December 31, 1996 and 1995, respectively, was 5.4% and 5.8%.

DEBENTURES

The Debentures are accounted for in accordance with SFAS No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructuring," and were initially recorded at an amount equal to the future undiscounted cash payments, both principal and interest ("SFAS No. 15 Interest"). Accordingly, no interest expense will be recognized over the life of these securities, and cash interest payments will be charged against the recorded amount of such securities. Interest on all of the Debentures is payable in cash semi-annually on June 15 and December 15 of each year.

The 5% First Priority Senior Subordinated Debentures, due December 15, 2003, had an outstanding principal amount of $269,993,000 at December 31, 1996, and are redeemable at any time at the Company's option at 100% of the principal amount.

The Second Priority Senior Subordinated Debentures were issued in three series, and each series is redeemable at any time at the Company's option at 100% of the principal amount and are described as follows:

- 4½% Series A Debentures, due June 15, 2004, with an outstanding principal amount of $123,654,000 at December 31, 1996.
- 4% Series B Debentures, due June 15, 2004, with an outstanding principal amount of $18,766,000 at December 31, 1996.
- 12% Series C Debentures, due June 15, 2009, with an outstanding principal amount of $21,787,000 at December 31, 1996.

In November 1995, the Company purchased $180,621,000 of the principal amount of its First Priority Senior Subordinated Debentures due 2003 ("5% Debentures") and $82,719,000 of the principal amount of its 4½% Second Priority Senior Subordinated Debentures (Series A) due 2004 ("4½% Debentures") (collectively, "Refinanced Debentures") with a portion of the proceeds from the issuance of $300 million principal amount of Convertible Quarterly Income Debt Securities (see Note 9). The purchase of the Refinanced Debentures resulted in an extraordinary gain of $103,169,000 (net of current tax effect of $8,603,000) as a result of the discounted purchase price and the inclusion of SFAS No. 15 Interest in the carrying amount of the debt.

Prior to the refinancing, the 5% Debentures were subject to annual sinking fund requirements of $27,045,000 due each December 15, commencing 1996 through 2002. The Company used its purchase of the 5% Debentures to satisfy such sinking fund requirements in direct order of maturity until December 15, 2002, at which time a sinking fund payment of $8,696,000 will be due.

The Debentures contain certain covenants that, among other things, (a) limit the payment of dividends and certain other restricted payments by both the Company and its subsidiaries, (b) require the purchase by the Company of the Debentures at the option of the holder upon a change of control, (c) limit additional indebtedness, (d) limit future exchange offers, (e) limit the repayment of subordinated indebtedness, (f) require board approval of certain asset sales, (g) limit transactions with certain stockholders and affiliates and (h) limit consolidations, mergers and the conveyance of all or substantially all of the Company's assets.

The First and Second Priority Senior Subordinated Debentures are subordinate to the borrowings outstanding under the Credit Agreement and to previously outstanding mortgages and notes that are either backed by specific collateral or are general unsecured, unsubordinated obligations. The Second Priority Debentures are subordinate to the First Priority Debentures.

YEN LOAN

In March 1988, the Company monetized its future royalty payments from SEJ, its area licensee in Japan, through a loan that is nonrecourse to the Company as to principal and interest. The original amount of the yen-denominated debt was 41 billion yen (approximately $327,000,000 at the exchange rate in March 1988)

and is collateralized by the Japanese trademarks and a pledge of the future royalty payments. By designating its future royalty receipts during the term of the loan to service the monthly interest and principal payments, the Company has hedged the impact of future exchange rate fluctuations. Payment of the debt is required no later than March 2006 through future royalties from the Japanese licensee, and the Company believes it is a remote possibility that there will be any principal balance remaining at that date. Upon the later of February 28, 2000, or the date which is one year following the final repayment of the loan, royalty payments from the area licensee in Japan will be substantially reduced in accordance with the terms of the license agreement. The current interest rate of 6¼% will be reset after March 1998.

CITYPLACE DEBT

Cityplace Center East Corporation ("CCEC"), a subsidiary of the Company, issued $290 million of notes in 1987 to finance the construction of the headquarters tower, a parking garage and related facilities of the Cityplace Center development. The interest rate on these notes was 7¾%, payable semiannually on February 15 and August 15, and the principal amount was due on February 15, 1995. Because of the application of purchase accounting in 1987, the effective interest rate was 9.0%. The principal amount was paid to noteholders on February 15, 1995, by drawings under letters of credit issued by The Sanwa Bank, Limited, Dallas Agency ("Sanwa"), which has a lien on the property financed. At that time, the Company deferred the maturity of the debt by exercising its option of extending the term of maturity ten years to March 1, 2005, with monthly payments of principal and interest to Sanwa based on a 25-year amortization at 7½%, with the remaining principal due upon maturity (the "Cityplace Term Loan").

The Company is occupying part of the building as its corporate headquarters and the balance is subleased. As additional consideration through the extended term of the debt, CCEC will pay to Sanwa an amount that it receives from the Company which is equal to the net sublease income that the Company receives on the property and 60% of the proceeds, less $275 million and permitted costs, upon a sale or refinancing of the building.

MATURITIES

Long-term debt maturities assume the continuance of the commercial paper program. The maturities, which include capital lease obligations and sinking fund requirements, as well as SFAS No. 15 Interest accounted for in the recorded amount of the Debentures, are as follows (dollars in thousands):

1997	$ 68,571
1998	131,594
1999	141,594
2000	139,102
2001	139,971
Thereafter	1,086,567
	$ 1,707,399

9. Convertible Quarterly Income Debt Securities Due 2010

In November 1995, the Company issued $300 million principal amount of Convertible Quarterly Income Debt Securities due 2010 ("Convertible Debt") to IY and SEJ. The Company used $216,739,000 of the proceeds to purchase the Refinanced Debentures (see Note 8), and the remaining proceeds were designated for general corporate purposes. The Convertible Debt has an interest rate of 4½% and gives the Company the right to defer interest payments thereon for up to 20 consecutive quarters. The holder of the Convertible Debt can convert it into a maximum of 72,112,000 shares of the Company's common shares. The conversion rate represents a premium to the market value of Southland's common stock at the time of issuance of the Convertible Debt. As of December 31, 1996, no shares had been issued as a result of debt conversion. The Convertible Debt is subordinate to all existing debt.

In addition to the principal amount of the Convertible Debt, the 1996 and 1995 financial statements include interest payable of $563,000 and $638,000 and interest expense of $13,658,000 and $1,332,000, respectively, related to the Convertible Debt.

10. Preferred Stock

The Company has 5,000,000 shares of preferred stock authorized for issuance. Any preferred stock issued will have such rights, powers and preferences as determined by the Company's Board of Directors.

11. Disclosures About Fair Value of Financial Instruments

The disclosure of the estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methodologies as indicated below.

The carrying amounts of cash and cash equivalents, trade accounts receivable, trade accounts payable and accrued expenses and other liabilities are reasonable estimates of their fair values. Letters of credit are included in the estimated fair value of accrued expenses and other liabilities.

The carrying amounts and estimated fair values of other financial instruments at December 31, 1996, are listed in the following table:

(Dollars in Thousands)	Carrying Amount	Estimated Fair Value
Bank Debt	$ 225,000	$ 225,000
Commercial Paper	398,055	398,055
Debentures	608,307	355,911
Yen Loan	201,447	226,071
Cityplace Term Loan	282,606	289,015
Convertible Debt		
— not practicable to estimate fair value	300,000	—

The methods and assumptions used in estimating the fair value for each of the classes of financial instruments presented in the table above are as follows:

- ▶ The carrying amount of the Bank Debt approximates fair value because the interest rates are variable.
- ▶ Commercial paper borrowings are sold at market interest rates and have an average remaining maturity of less than 26 days. Therefore, the carrying amount of commercial paper is a reasonable estimate of its fair value. The guarantee of the commercial paper by IY is an integral part of the estimated fair value of the commercial paper borrowings.
- ▶ The fair value of the Debentures is estimated based on December 31, 1996, bid prices obtained from investment banking firms where traders regularly make a market for these financial instruments. The carrying amount of the Debentures includes $174,106,000 of SFAS No. 15 Interest.
- ▶ The fair value of the Yen Loan is estimated by calculating the present value of the future yen cash flows at current interest and exchange rates.
- ▶ The fair value of the Cityplace Term Loan is estimated by calculating the present value of the future cash flows at current interest rates.
- ▶ It is not practicable, without incurring excessive costs, to estimate the fair value of the Convertible Debt at December 31, 1996. The fair value would be the sum of the fair values assigned to both an interest rate and an equity component of the debt by a valuation firm.

12. Employee Benefit Plans

Profit Sharing Plans

The Company maintains profit sharing plans for its U.S. and Canadian employees. In 1949, the Company excluding its Canadian subsidiary ("Southland") adopted The Southland Corporation Employees' Savings and Profit Sharing Plan (the "Savings and Profit Sharing Plan") and, in 1970, the Company's Canadian subsidiary adopted the Southland Canada, Inc., Profit Sharing Pension Plan. These plans provide retirement benefits to eligible employees.

Contributions to the Savings and Profit Sharing Plan, a 401(k) defined contribution plan, are made by both the participants and Southland. Southland contributes the greater of approximately 10% of its net earnings or an amount determined by Southland's president. Net earnings as amended during 1995 are calculated without regard to the contribution to the Savings and Profit Sharing Plan, federal income taxes, gains from debt repurchases and refinancings and, at the discretion of Southland's president, income from accounting changes. The contribution by Southland is generally allocated to the participants on the basis of their individual contribution and years of participation in the Savings and Profit Sharing Plan. The provisions of the Southland Canada, Inc., Profit Sharing Pension Plan are similar to those of the Savings and Profit Sharing Plan. Total contributions to these plans for the years ended December 31, 1996, 1995 and 1994 were $14,069,000, $11,318,000 and $10,513,000, respectively, and are included in OSG&A.

POSTRETIREMENT BENEFITS

The Company's group insurance plan (the "Insurance Plan") provides postretirement medical and dental benefits for all retirees that meet certain criteria. Such criteria include continuous participation in the Insurance Plan ranging from 10 to 15 years depending on hire date, and the sum of age plus years of continuous service equal to at least 70. The Company contributes toward the cost of the Insurance Plan a fixed dollar amount per retiree based on age and number of dependents covered, as adjusted for actual claims experience. All other future costs and cost increases will be paid by the retirees. The Company continues to fund its cost on a cash basis; therefore, no plan assets have been accumulated.

Net periodic postretirement benefit costs for 1996, 1995 and 1994 include the following components:

(Dollars in Thousands)	1996	1995	1994
Service cost	$ 595	$ 585	$ 752
Interest cost	1,496	1,678	1,732
Amortization of unrecognized gain	(498)	(583)	(61)
	$ 1,593	$ 1,680	$ 2,423

The weighted-average discount rate used in determining the accumulated postretirement benefit obligation was 7.5% and 7% at December 31, 1996 and 1995, respectively. Components of the accrual recorded in the Company's consolidated balance sheets are as follows:

	December 31	
(Dollars in Thousands)	1996	1995
Accumulated Postretirement		
Benefit Obligation:		
Retirees	$ 11,174	$ 11,960
Active employees eligible to retire	4,772	5,234
Other active employees	5,251	6,328
	21,197	23,522
Unrecognized gains	7,627	5,198
	$ 28,824	$ 28,720

STOCK INCENTIVE PLAN

The Southland Corporation 1995 Stock Incentive Plan (the "Stock Incentive Plan") was adopted by the Company in October 1995 and approved by the shareholders in April 1996. The Stock Incentive Plan provides for the granting of stock options, stock appreciation rights, performance shares, restricted stock, restricted stock units, bonus stock and other forms of stock-based awards and authorizes the issuance of up to 41 million shares over a ten-year period. In October 1996 and 1995, respectively, 3,977,640 and 3,863,600 options were granted with an exercise price of $3.00 and $3.1875 per share, which was equal to the fair market value on the date of grant, to certain key employees and officers of the Company. The options granted in both 1996 and 1995 are exercisable in five equal installments beginning one year after grant date with possible acceleration thereafter based upon certain improvements in the price of a share of Southland's common stock.

The Company is accounting for the Stock Incentive Plan under the provisions of APB No. 25 (see Note 1) and, accordingly, no compensation cost has been recognized. If compensation cost had been determined based on the fair value at the grant date for awards under this plan consistent with the method prescribed by SFAS No. 123, the Company's net earnings and earnings per share for the years ended December 31, 1996 and 1995, would have been reduced to the pro forma amounts indicated in the table below:

(Dollars in Thousands, Except Per-Share Data)	1996	1995
Net earnings:		
As reported	$ 89,476	$ 270,763
Pro forma	88,520	270,610
Primary and fully diluted earnings per common share:		
As reported	$ .20	$ .65
Pro forma	.20	.65

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for the options granted: for both 1996 and 1995, expected volatility of 55.49%, expected life of five years and no dividend yields, combined with risk-free interest rates of 6.39% in 1996 and 5.89% in 1995.

A summary of the status of the Stock Incentive Plan as of December 31, 1996 and 1995, and changes during the years ending on those dates, is presented below:

	1996		1995	
Fixed Options	Shares (000's)	Weighted-Average Exercise Price	Shares (000's)	Weighted-Average Exercise Price
Outstanding at beginning of year	3,864	$ 3.1875	—	—
Granted	3,978	3.0000	3,864	$ 3.1875
Exercised	—	—	—	—
Forfeited	(224)	3.1875	—	—
Outstanding at end of year	7,618	$ 3.0895	3,864	$ 3.1875
Options exercisable at year-end	728	$ 3.1875	—	—
Weighted-average fair value of options granted during the year	$ 1.6413		$ 1.7243	

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Options Outstanding at 12/31/96	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Options Exercisable at 12/31/96	Weighted-Average Exercise Price
$ 3.0000	3,977,640	9.75	$ 3.0000	—	—
3.1875	3,640,000	8.81	3.1875	728,000	$ 3.1875
3.0000-3.1875	7,617,640	9.30	3.0895	728,000	3.1875

EQUITY PARTICIPATION PLAN

In 1988, the Company adopted The Southland Corporation Equity Participation Plan (the "Participation Plan"), which provides for the granting of both incentive options and nonstatutory options and the sale of convertible debentures to certain key employees and officers of the Company. In the aggregate, not more than 3,529,412 shares of common stock of the Company can be issued pursuant to the Participation Plan; however, the Company has no present intent to grant additional options or debentures under this plan. The shares available for issuance under the Participation Plan are reduced by the number of shares issued under the Grant Stock Plan, which is described in a following paragraph.

Options were granted in 1988 at the fair market value on the date of grant, which is the same as the conversion price provided in the debentures. All options and convertible debentures that were vested became exercisable as of December 31, 1994, pursuant to the terms of the Participation Plan. At December 31, 1996, there were vested options outstanding to acquire 923,500 shares, of which 885,000 were at $7.50 per share and 38,500 were at $7.70 per share, and vested debentures outstanding that were convertible at $7.50 per share into 5,000 shares. During 1996, options to acquire 25,000 shares expired for those participants who are no longer with the Company. All options expire, and the debentures mature, no later than December 31, 1997.

GRANT STOCK PLAN

In 1988, the Company adopted The Southland Corporation Grant Stock Plan (the "Stock Plan"). Under the provisions of the Stock Plan, up to 750,000 shares of common stock are authorized to be issued to certain key employees and officers of the Company. Shares issued under the Stock Plan decrease the number of shares that can be issued pursuant to the Participation Plan. The stock is fully vested upon the date of issuance. As of December 31, 1996, 480,844 shares had been issued pursuant to the Stock Plan. No shares have been issued since 1988, and the Company has no present intent to grant additional shares.

13. LEASES

LEASES

Certain property and equipment used in the Company's business is leased. Generally, real estate leases are for primary terms from 14 to 20 years with options to renew for additional periods, and equipment leases are for terms from one to ten years. The leases do not contain restrictions that have a material effect on the Company's operations.

The composition of capital leases reflected as property and equipment in the consolidated balance sheets is as follows:

	December 31	
(Dollars in Thousands)	1996	1995
Buildings	$ 106,358	$ 116,412
Equipment	142	225
	106,500	116,637
Accumulated amortization	(71,019)	(77,428)
	$ 35,481	$ 39,209

The present value of future minimum lease payments for capital lease obligations is reflected in the consolidated balance sheets as long-term debt. The amount representing imputed interest necessary to reduce net minimum lease payments to present value has been calculated generally at the Company's incremental borrowing rate at the inception of each lease.

Future minimum lease payments for years ending December 31 are as follows:

(Dollars in Thousands)	Capital Leases	Operating Leases
1997	$ 20,593	$ 124,246
1998	19,042	105,101
1999	17,717	83,095
2000	15,816	64,790
2001	13,677	49,413
Thereafter	52,548	164,390
Future minimum lease payments	139,393	$ 591,035
Estimated executory costs	(288)	
Amount representing imputed interest	(56,272)	
Present value of future minimum lease payments	$ 82,833	

Minimum noncancellable sublease rental income to be received in the future, which is not included above as an offset to future payments, totals $19,676,000 for capital leases and $17,381,000 for operating leases.

Rent expense on operating leases for the years ended December 31, 1996, 1995 and 1994, totaled $132,760,000, $125,456,000 and $120,850,000, respectively, including contingent rent expense of $9,438,000, $8,508,000 and $8,576,000, but reduced by sublease rent income of $7,175,000, $7,296,000 and $7,858,000. Contingent rent expense on capital leases for the years ended December 31, 1996, 1995 and 1994, was $2,088,000, $2,399,000 and $2,822,000, respectively. Contingent rent expense is generally based on sales levels or changes in the Consumer Price Index.

LEASES WITH THE SAVINGS AND PROFIT SHARING PLAN

At December 31, 1996, the Savings and Profit Sharing Plan owned 152 stores leased to the Company under capital leases and 641 stores leased to the Company under operating leases at rentals which, in the opinion of management, approximated market rates at the date of lease. In addition, 38, 67 and 43 properties were sold by the Savings and Profit Sharing Plan to third parties in 1996, 1995 and 1994, respectively, and at the same time, any related leases with the Company were either cancelled or assigned to the new owner. Included in the consolidated financial statements are the following amounts related to leases with the Savings and Profit Sharing Plan:

	December 31	
(Dollars in Thousands)	1996	1995
Buildings (net of accumulated amortization of $6,718 and $8,853)	$ 1,144	$ 2,041
Capital lease obligations (net of current portion of $1,200 and $1,664)	$ 1,055	$ 2,310

	Years Ended December 31		
(Dollars in Thousands)	1996	1995	1994
Rent expense under operating leases and amortization of capital lease assets	$ 25,670	$ 26,850	$ 28,195
Imputed interest expense on capital lease obligations	$ 299	$ 483	$ 696
Capital lease principal payments included in principal payments under long-term debt agreements	$ 1,580	$ 1,818	$ 2,075

14. Commitments and Contingencies

MCLANE COMPANY, INC.

In connection with the 1992 sale of distribution and food center assets to McLane, the Company and McLane entered into a ten-year service agreement under which McLane is making its distribution services available to 7-Eleven stores in the United States. If the Company does not fulfill its obligation to McLane during this time period, the Company must reimburse McLane on a pro-rata basis for the transitional payment received at the time of the transaction. The original payment received of $9,450,000 in 1992 is being amortized to cost of goods sold over the life of the agreement. The Company has exceeded the minimum annual purchases each year and expects to exceed the minimum required purchase levels in future years.

CITGO PETROLEUM CORPORATION

In 1986, the Company entered into a 20-year product purchase agreement with Citgo to buy specified quantities of gasoline at market prices. These prices are determined pursuant to a formula based on the prices posted by gasoline wholesalers in the various market areas where the Company purchases gasoline from Citgo. Minimum required annual purchases under this agreement are generally the lesser of 750 million gallons or 35% of gasoline purchased by the Company for retail sale. The Company has exceeded the minimum required annual purchases each year and expects to exceed the minimum required annual purchase levels in future years.

ENVIRONMENTAL

In December 1996, the Company adopted the American Institute of Certified Public Accountants' recently issued Statement of Position ("SOP") No. 96-1, "Environmental Remediation Liabilities," which is required for fiscal years beginning after December 15, 1996. SOP No. 96-1 provides guidance on specific accounting issues that are present in the recognition, measurement and disclosure of environmental remediation liabilities.

In December 1988, the Company closed its chemical manufacturing facility in New Jersey. As a result, the Company is required to conduct environmental remediation at the facility and has submitted a clean-up plan to the New Jersey Department of Environmental Protection (the "State"), which provides for remediation of the site for approximately a three- to- five-year period, as well as continued groundwater treatment for a projected 20-year period. While the Company has recently received conditional approval of its clean-up plan, the Company must supply additional information to the State before the plan can be finalized. The Company has recorded undiscounted liabilities representing its best estimates of the clean-up costs of $30,900,000 and $37,824,000 at December 31, 1996 and 1995, respectively. Of this amount, $25,246,000 and $31,660,000 are included in deferred credits and other liabilities and the remainder in accrued expenses and other liabilities for the respective years.

In 1991, the Company and the former owner of the facility executed a final settlement pursuant to which the former owner agreed to pay a substantial portion of the clean-up costs. Based on the terms of the settlement agreement and the financial resources of the former owner, the Company has recorded receivable amounts of $18,227,000 and $22,035,000 at December 31, 1996 and 1995, respectively. Of this amount, $14,861,000 and $18,381,000 are included in other assets and the remainder in accounts receivable for 1996 and 1995, respectively.

Additionally, the Company accrues for the anticipated future costs and the related probable state reimbursement amounts for remediation activities at its existing and previously operated gasoline store sites where releases of regulated substances have been detected. At December 31, 1996 and 1995, respectively, the Company's estimated undiscounted liability for these sites was $46,508,000 and $63,669,000, of which $28,508,000 and $29,174,000 are included in deferred credits and other liabilities and the remainder is included in accrued expenses and other liabilities. These estimates were based on the Company's prior experience with gasoline sites and its consideration of such factors as the age of the tanks, location of tank sites and experience with contractors who perform environmental assessment and remediation work. The Company anticipates that substantially all of the future remediation costs for detected releases at these sites as of December 31, 1996, will be incurred within the next five years.

Under state reimbursement programs, the Company is eligible to receive reimbursement for a portion of future remediation costs, as well as remediation costs previously paid. Accordingly, the Company has recorded net receivable amounts of $50,025,000 and $59,652,000 for the estimated probable state reimbursements, of which $39,025,000 and $45,653,000 are included in other assets and the remainder in accounts receivable for 1996 and 1995, respectively. The Company increased the estimated net environmental cost reimbursements at the end of 1996 by approximately $7,500,000 as a result of completing a review of state reimbursement programs. In assessing the probability of state reimbursements, the Company takes into consideration each state's fund balance, revenue sources, existing claim backlog, status of clean-up activity and claim ranking systems. As a result of these assessments, the recorded receivable amounts are net of allowances of $9,459,000 and $13,705,000 for 1996 and 1995, respectively. While there is no assurance of the timing of the receipt of state reimbursement funds, based on the Company's experience, the Company expects to receive the majority of state reimbursement funds, except from California, within one to three years after payment of eligible remediation expenses, assuming that the state administrative procedures for processing such reimbursements have been fully developed. The Company estimates that it may take one to eight years

to receive reimbursement funds from California. Therefore, the portion of the recorded receivable amounts that relate to sites where remediation activities have been completed have been discounted at 7% to reflect their present value. As a result of the adoption of SOP No. 96-1, the 1996 recorded receivable amount is also net of a discount of $6,398,000.

The estimated future remediation expenditures and related state reimbursement amounts could change within the near future as governmental requirements and state reimbursement programs continue to be implemented or revised.

15. Income Taxes

The components of earnings before income taxes and extraordinary gain are as follows:

	Years Ended December 31		
(Dollars in Thousands)	1996	1995	1994
Domestic (including royalties of $63,536, $59,044 and $54,917 from area license agreements in foreign countries)	$ 124,316	$ 98,775	$ 70,615
Foreign	6,508	2,754	2,881
	$ 130,824	$ 101,529	$ 73,496

The provision for income taxes in the accompanying Consolidated Statements of Earnings consists of the following:

	Years Ended December 31		
(Dollars in Thousands)	1996	1995	1994
Current:			
Federal	$ 5,054	$ 8,251	$ 6,799
Foreign	10,704	8,968	8,515
State	1,800	985	350
Tax benefit of operating loss carryforward	—	—	(4,164)
Subtotal	17,558	18,204	11,500
Deferred:			
Provision	23,790	60,709	—
Beginning of year valuation allowance adjustment	—	(144,978)	(30,000)
Subtotal	23,790	(84,269)	(30,000)
Income taxes before extraordinary gain	$ 41,348	$ (66,065)	$ (18,500)

Included in Shareholders' Equity at December 31, 1996 and 1995, respectively, are $6,882,000 and $5,208,000 of income taxes provided on unrealized gains on marketable securities.

Reconciliations of income taxes before extraordinary gain at the federal statutory rate to the Company's actual income taxes provided are as follows:

	Years Ended December 31		
(Dollars in Thousands)	1996	1995	1994
Taxes at federal statutory rate	$ 45,788	$ 35,535	$ 25,724
State income taxes, net of federal income tax benefit	1,170	640	228
Foreign tax rate difference	1,077	886	1,212
Net change in valuation allowance excluding the tax effect of the 1995 extraordinary item	—	(108,632)	(47,943)
Settlement of IRS examination	(7,261)	—	—
Other	574	5,506	2,279
	$ 41,348	$ (66,065)	$ (18,500)

The valuation allowance for deferred tax assets decreased in 1995 by $174,589,000. The decrease consisted of a $90,320,000 decrease resulting from changes in the Company's gross deferred tax assets and liabilities and an $84,269,000 decrease resulting from a change in estimate regarding the realizability of the Company's deferred tax assets. Based on the Company's trend of positive earnings during the past three years and future expectations, the Company determined that it is more likely than not that its deferred tax assets will be fully realized. In 1994, the valuation allowance decreased by $42,078,000 due to changes in the Company's gross deferred tax assets and liabilities and the realization of $30,000,000 of the Company's net deferred tax asset.

Significant components of the Company's deferred tax assets and liabilities are as follows:

(Dollars in Thousands)	December 31 1996	December 31 1995
Deferred tax assets:		
SFAS No. 15 interest	$ 75,037	$ 81,038
Compensation and benefits	42,573	44,592
Accrued insurance	39,494	43,270
Accrued liabilities	35,677	39,665
Tax credit carryforwards	8,924	14,834
Debt issuance costs	8,059	6,820
Other	5,056	5,560
Subtotal	214,820	235,779
Deferred tax liabilities:		
Area license agreements	(77,811)	(85,164)
Property and equipment	(41,636)	(32,853)
Other	(11,777)	(8,701)
Subtotal	(131,224)	(126,718)
Net deferred taxes	$ 83,596	$ 109,061

The Company's net deferred tax asset is recorded in other current assets and other assets (see Notes 4 and 6).

At December 31, 1996, the Company had approximately $8,924,000 of alternative minimum tax ("AMT") credit carryforwards. The AMT credits have no expiration date.

16. Earnings Per Common Share

Primary earnings per common share is computed by dividing net earnings, plus Convertible Debt interest (see Note 9) net of tax benefits, by the weighted average number of common shares and common share equivalents outstanding during each year. The exercise of outstanding stock options would not result in a dilution of earnings per share.

17. Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for 1996 and 1995 is as follows:

(Dollars in Millions, Except Per-Share Data) Year Ended December 31, 1996	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Net sales	$ 1,563	$ 1,792	$ 1,840	$ 1,674	$ 6,869
Gross profit	442	525	541	468	1,976
Income taxes (benefit)	4	20	25	(8)	41
Net earnings	5	30	38	16	89
Primary and fully diluted earnings per common share	.02	.07	.08	.04	.20

(Dollars in Millions, Except Per-Share Data) Year Ended December 31, 1995	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Net sales	$ 1,545	$ 1,750	$ 1,826	$ 1,625	$ 6,746
Gross profit	449	512	554	468	1,983
Income taxes (benefit)	2	9	12	(89)	(66)
Earnings (loss) before extraordinary gain	(1)	37	50	82	168
Net earnings (loss)	(1)	37	50	185	271
Primary and fully diluted earnings per common share before extraordinary gain	—	.09	.12	.19	.40

The second quarter of 1995 includes a $4,679,000 environmental reimbursement related to outstanding litigation. The fourth quarter of 1995 includes a $103,169,000 extraordinary gain on redemption of debt related to the refinancing of certain debt securities (see Note 8), $84,269,000 from realization of a deferred tax asset (see Note 15) and $13,415,000 of expenses accrued for severance and related costs (see Note 7).

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
The Southland Corporation
Dallas, Texas

We have audited the accompanying consolidated balance sheets of The Southland Corporation and Subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of earnings, shareholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Southland Corporation and Subsidiaries as of December 31, 1996 and 1995, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Dallas, Texas
February 18, 1997

DIRECTORS

As of December 31, 1996

MASATOSHI ITO
Chairman of the Board;
Director, Honorary Chairman,
Ito-Yokado Group

TOSHIFUMI SUZUKI[1]
Vice Chairman of the Board;
President and Chief Executive Officer,
Ito-Yokado Co., Ltd.;
Chairman and Chief Executive Officer,
Seven-Eleven Japan Co., Ltd.

CLARK J. MATTHEWS, II
President and
Chief Executive Officer;
Secretary,
The Southland Corporation

YOSHITAMI ARAI
Chairman of the Board,
Systems International Incorporated

TIMOTHY ASHIDA
President,
A.K.K. Associates, Inc.

JAY W. CHAI[2]
Chairman of the Board and
Chief Executive Officer,
ITOCHU International Inc.

GARY J. FERNANDES[1][2]
Vice Chairman,
Electronic Data Systems Corporation

MASAAKI KAMATA
Director and
Executive Vice President,
Seven-Eleven Japan Co., Ltd.

KAZUO OTSUKA[1]
General Manager,
Corporate Development,
Ito-Yokado Co., Ltd.

ASHER O. PACHOLDER[2]
Chairman of the Board
and Chief Financial Officer,
ICO, Inc.

NOBUTAKE SATO
Chief Financial Officer,
Ito-Yokado Co., Ltd.

(1) Compensation and Benefits Committee
(2) Audit Committee

OFFICERS

As of December 31, 1996

MASATOSHI ITO
Chairman of the Board

TOSHIFUMI SUZUKI
Vice Chairman of the Board

CLARK J. MATTHEWS, II
President,
Chief Executive Officer
and Secretary

JAMES W. KEYES
Executive Vice President
and Chief Financial Officer

STEPHEN B. KRUMHOLZ
Executive Vice President
and Chief Operating Officer

RODNEY A. BREHM
Senior Vice President,
Distribution

MICHAEL R. CUTTER
Senior Vice President,
Merchandising

ADRIAN O. EVANS
Senior Vice President,
Construction and Maintenance

STEPHEN B. LEROY
Senior Vice President,
International and Real Estate

BRYAN F. SMITH, JR.
Senior Vice President and
General Counsel

ROBERT E. BAILEY
Vice President,
Northwest Division

TERRY L. BLOCHER
Vice President,
Southwest Division

PAUL L. BUREAU, JR.
Vice President,
Corporate Tax

KATHLEEN CALLAHAN-GUION
Vice President,
Chesapeake Division

FRANK CRIVELLO
Vice President,
Northeast Division

JOSEPH F. GOMES
Vice President,
Central Division

JOHN W. HARRIS
Vice President,
Florida Division

JAMES NOTARNICOLA
Vice President,
Communications

GARY R. ROSE
Vice President,
Gasoline and Environmental Services

JEFFREY A. SCHENCK
Vice President,
Greater Midwest Division

DAVID A. URBEL
Vice President,
Planning and Treasurer

DONALD E. THOMAS
Controller

Corporate Information

Corporate Headquarters

The Southland Corporation
2711 North Haskell Ave.
Dallas, TX 75204-2906
(214) 828-7011

Mailing Address:
P.O. Box 711
Dallas, TX 75221-0711

Form 10-K and Other Investor Information

Requests for the Form 10-K for the year ended December 31, 1996, and quarterly financial information should be addressed to the Investor Relations Department at the above address, or telephone (214) 828-7587.

Annual reports are mailed to all shareholders of record. Investors may receive quarterly information regularly by requesting to be included on the company's mailing list.

A recorded company update can be reached and requests for information can be left 24 hours a day by calling (214) 828-7587.

Annual Meeting

The annual meeting will be held at 9:30 a.m. CDT on Wednesday, April 23, 1997, in the Cityplace Conference Center at the company's headquarters. All shareholders and bondholders are cordially invited to attend.

Auditors

Coopers & Lybrand L.L.P.
Dallas, Texas

Common Stock

Southland's common stock is traded on The Nasdaq Stock Market under the ticker symbol SLCM. There were 2,834 shareholders of record as of March 7, 1997.

The company pays no dividends on its common equity as such payments are restricted by the indentures governing its outstanding securities and by Southland's Credit Agreement with its senior lenders.

The table below sets forth the high, low and closing market prices for the periods indicated as provided by Nasdaq.

	Price Range		
Quarters	High	Low	Close
1996			
First	$ 4 1/16	$ 2 15/16	$ 3 5/16
Second	4 15/16	3	3 1/32
Third	3 5/8	3	3 1/32
Fourth	3 5/32	2 7/16	2 31/32
1995			
First	$ 4 23/32	$ 3 7/16	$ 3 3/4
Second	4 3/8	3 7/16	3 7/16
Third	4 1/8	2 7/8	3
Fourth	4 1/4	2 15/16	3 5/16

Common Stock Transfer Agent/Registrar

Harris Trust and Savings Bank
77 Water Street, 4th Floor
New York, NY 10005
(212) 701-7681
(800) 926-1269

Other Securities

The following other Southland securities are traded over the counter, and price information is available by calling the company's recorded message at (214) 828-7587:

5% First Priority Senior Subordinated Debentures
Trustee: Mellon Bank, F.S.B.
Two Mellon Bank Center, Room 325
Pittsburgh, PA 15259-0001

4½% Second Priority Senior Subordinated Debentures (Series A)
4% Second Priority Senior Subordinated Debentures (Series B)
12% Second Priority Senior Subordinated Debentures (Series C)
Trustee: The Bank of New York
101 Barclay Street, Floor 21 West
New York, NY 10286

The Southland Corporation
2711 North Haskell Avenue
Dallas, Texas 75204-2906
Tel: (214) 828-7011